

No. **78-289**

Supreme Court, U. S.
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In the Supreme Court of the United States

OCTOBER TERM, 1978

**FEDERAL DEPOSIT INSURANCE CORPORATION,
PETITIONER**

v.

FIRST EMPIRE BANK—NEW YORK, ET AL.

**PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR
THE NINTH CIRCUIT**

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The Solicitor General, on behalf of the Federal Deposit Insurance Corporation, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. A, *infra*, pp. 1a-30a) is reported at 572 F.2d 1361. The opinion of the district court (App. B, *infra*, pp. 31a-48a) is not reported.

JURISDICTION

The judgment of the court of appeals (App. A, *infra*, p. 28a) was entered on April 6, 1978. On June 26, 1978, Mr. Justice Rehnquist extended the time for filing a petition for a writ of certiorari to and including August 21, 1978. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the Federal Deposit Insurance Corporation, in arranging the purchase of a failed bank's assets and the assumption of that bank's liabilities by a sound bank under 12 U.S.C. 1823(e), must guarantee payment of every obligation of the failed bank.

STATUTORY PROVISIONS INVOLVED

Pertinent provisions of the National Bank Act, R.S. 5242, and 5236, 12 U.S.C. 91 and 194, and of the Federal Deposit Insurance Act, 64 Stat. 884, 12 U.S.C. 1821(c), 1821(d), and 1823(e), are contained in Appendix C, *infra*, pp. 49a-56a

STATEMENT

1. This case arises out of the second-largest bank failure in American history—the collapse in 1973 of the United States National Bank (USNB), which had 62 offices and nearly \$1 billion in 344,000 deposit accounts (App. A, *infra*, pp. 6a-7a). At the time it failed, USNB was insolvent and its liabilities exceeded its assets by a substantial amount. Ap-

proximately \$300 million in deposits were not insured (*id.* at 7a). When it closed, USNB was the obligor on more than \$100 million in letters of credit (App. B, *infra*, pp. 35a-36a). Approximately \$45 million of this amount concerned standby letters of credit that USNB had issued to respondents and others to guarantee debts incurred by USNB's controlling stockholder, C. Arnholt Smith, and Smith's associates (the "Designated Group").¹

A standby letter of credit secures the obligation of the borrower by requiring the issuer (here, USNB) to pay the debt if the borrower (here, the Designated Group) should default. See App. A, *infra*, pp. 10a-13a. Respondents and other creditors insisted on standby letters of credit from USNB as a condition of making loans to members of the Designated Group because the creditworthiness of those borrowers was suspect. See *id.* at 8a-9a, 12a-13a. Thus the Designated Group, because it controlled USNB, was able to obtain USNB's guarantee of their personal debts—debts they could not have incurred if they had relied solely on their own creditworthiness.

When the Comptroller of the Currency (Comptroller) declared USNB insolvent, he appointed the Federal Deposit Insurance Corporation (FDIC) receiver, as 12 U.S.C. 1821(c) requires. The FDIC could have liquidated USNB's assets and paid in-

¹ See generally Hearings on the Failure of the United States National Bank of San Diego before the Subcommittee on Bank Supervision and Insurance of the House Committee on Banking and Currency, 93d Cong., 1st Sess. 37-38, 54-99 (1973).

sured depositors the amount of their deposits, up to the statutory limit then in effect. But the insurance would have left approximately \$300 million unpaid (App. A, *infra*, p. 7a), and liquidation would have seriously disrupted the financial affairs of hundreds of thousands of entirely innocent persons, including depositors, borrowers, and those to whom depositors had given checks (*id.* at 6a-7a).

The FDIC chose to avoid this disruption by arranging a purchase and assumption transaction under 12 U.S.C. 1823(e).² It sought to locate a sound bank that would be able and willing, with the help of the FDIC, to purchase the assets and assume the liabilities of USNB. There was, however, a general belief in the banking community that USNB's failure had been caused in large part by mismanagement of USNB by the Designated Group;³ every qualified bank that FDIC approached concluded that the Designated Group members were so unlikely to pay their

² Such a transaction begins when the FDIC solicits bids from going banks to take over a failed or failing bank. One going bank purchases the assets, and assumes certain of the liabilities, of the failed bank. The FDIC (in its corporate capacity) lends to itself (as receiver) a sum sufficient to bring the failed bank's assets and liabilities into balance. As receiver, it transfers this sum (less whatever the acquiring bank pays for the failed bank) to the acquiring bank, and FDIC takes a lien on whatever assets remain in the failed bank's "estate." 12 U.S.C. 1823(e). The text describes the operation of this procedure in USNB's case.

³ Both the Securities and Exchange Commission and the Internal Revenue Service then were investigating Smith and his associates (App. A, *infra*, p. 8a).

debts that the assumption of the standby letters of credit which USNB had issued on their behalf (and at their behest) presented unacceptable banking risks (App. A, *infra*, pp. 7a-8a). Prospective purchasers therefore refused to take over USNB unless FDIC either guaranteed USNB's obligations concerning the Designated Group or eliminated those obligations⁴ from the transaction (*id.* at 8a). Rather than placing its insurance fund behind these suspect letters of credit, the FDIC excluded them from the obligations to be assumed by a purchasing bank.

FDIC then sought bids from interested banks. Crocker National Bank was the highest bidder, and most of USNB's assets (approximately \$855 million) and liabilities (approximately \$1.073 billion) were transferred to Crocker for \$89.5 million (App. A, *infra*, p. 9a). FDIC also transferred to Crocker some \$128 million, which was the difference between the assets Crocker had purchased and the liabilities it had assumed, less the amount of its bid (*ibid.*). Following this transfer, all domestic USNB offices continued in operation as branches of Crocker without interruption in services. FDIC took a first lien on all unpurchased assets of USNB (see 12 U.S.C. 1823(e)). Because this lien dwarfed USNB's remaining assets, the standby letters of credit became worthless.

⁴ And the corresponding assets, which included the Designated Group's personal promises to make USNB whole for any loss it might suffer in making payments on the standby letters of credit.

2. Respondents, two creditors of the Designated Group, filed this suit against the FDIC in the United States District Court for the Southern District of California. They alleged that the purchase and assumption transaction was illegal because it violated two sections of the National Bank Act. First, it allegedly gave USNB creditors whose claims Crocker assumed preference over the respondents and was therefore contrary to 12 U.S.C. 91, which voids "all payments of money * * * made after the Commission of an act of insolvency * * * with a view to the preference of one creditor to another * * *." Respondents also alleged that the purchase and assumption was a dividend of USNB's assets to those whose claims Crocker had assumed, and that the distribution was therefore not "ratable" under 12 U.S.C. 194, which requires the Comptroller to "make a ratable dividend of the money * * * paid over to him by [the insolvent bank's] receiver on all such claims as may have been proved to his satisfaction * * *."

The FDIC contended that a purchase and assumption transaction is not governed by Sections 91 and 194 but instead is controlled by provisions of the Federal Deposit Insurance Act, 64 Stat. 873, 12 U.S.C. 1811 *et seq.*, that authorize the FDIC to implement purchase and assumption transactions "upon such terms and conditions as it may determine * * *." 12 U.S.C. 1823(e).

The district court, following a non-jury trial, held that the purchase and assumption transaction was authorized by 12 U.S.C. 1823(e) and did not violate

either 12 U.S.C. 91 or 12 U.S.C. 194 (App. B, *infra*, p. 47a). The court also concluded that the FDIC's actions were "reasonable, not arbitrary or capricious and were founded on a rational basis" (*id.* at 48a).⁵

3. The court of appeals reversed. It recognized that, because the FDIC is both an insurer of deposits in a failed national bank (see 12 U.S.C. 1821(f)) and the receiver of such a bank (see 12 U.S.C. 1821(c)), it is "in the unusual position of acting in two capacities with respect to national banks closed by the Comptroller: in its corporate capacity, as insurer of deposits (* * * 'the Corporation'), and in its capacity as receiver (* * * 'the Receiver')." This duality requires the FDIC frequently to deal with itself, *e.g.*, to lend or sell to itself" (App. A, *infra*, p. 4a). The court also acknowledged that, under the Federal Deposit Insurance Act, the FDIC in its corporate capacity may arrange purchase and assumption transactions such as that involved in this case and lend to itself, as receiver, an amount of money sufficient to bring the purchase and assumption transaction into balance (*id.* at 4a-5a).

The court nevertheless held that 12 U.S.C. 1823(e) "cannot be read to excuse the FDIC as the Receiver from complying with" the ratable distribution and anti-preference provisions of the National Bank

⁵ The district court rejected FDIC's defense that the standby letters of credit were not provable against it as receiver (App. B, *infra*, pp. 45a-47a), and the court of appeals agreed with this holding (App. A, *infra*, pp. 13a-19a). We do not present this aspect of the decision for review by this Court.

Act (App. A, *infra*, p. 22a). The court stated that Section 1823(e)'s provision enabling the FDIC to arrange purchase and assumption transactions "upon such terms and conditions as it may determine" refers to the FDIC only in its corporate capacity; when the FDIC also acts as a receiver, it must comply with the restrictions that 12 U.S.C. 91 and 194 place on receivers (App. A, *infra*, pp. 22a-23a). The court concluded that (*id.* at 25a):

the responsibility lies on the FDIC under § 194 to compensate [respondents] for its failure as Receiver to make distributions ratably. [Had it insisted that these [respondents] be included in the purchase and assumption agreement as creditors with claims assumed by Crocker, as it should have done, it would then have had to satisfy Crocker by adding to the amount borrowed from the Corporation and paid to Crocker the full amount of the claims. That sum [respondents] are now entitled to receive from the FDIC.^[6]]

REASONS FOR GRANTING THE PETITION

1. The court of appeals has significantly restricted the authority that Congress has granted the Federal Deposit Insurance Corporation to deal with the consequences of bank failure. The decision in this case

* The court of appeals also held that respondents are "entitled to recover interest accruing on each letter from the date of its maturity, the dates on which the distribution would have been made had all the claims been ratably treated" (App. A, *infra*, p. 27a).

requires the FDIC's deposit insurance fund to guarantee the commercial risks that respondents, as professional banks, took in lending money to members of the Designated Group. This result may well encourage lenders to make loans to a bank's controlling shareholders, with little or no regard for the financial stability of either the borrowers or the bank; such loans, which could jeopardize the credit of the controlled bank, might contribute to additional bank failures. But even if the decision does not contribute to financial mismanagement of banks, it turns the FDIC's insurance fund, which Congress created to protect innocent depositors in the event of failure, into a guarantor of loans made by professional bankers to other bankers.

Although there has been little appellate litigation concerning the FDIC's purchase and assumption transactions, the question presented by this case arises frequently and is important to the FDIC's operations and to the ability of the agency to prevent financial disruptions that otherwise would be caused by bank insolvency. Since 1970, sixty-one banks, with some \$4 billion in deposits insured by the FDIC, have closed.⁷ The FDIC arranged purchase and assumption transactions in more than two-thirds of these cases. The court of appeals' decision in this case

⁷ The court of appeals was mistaken in stating that "[s]ince passage of the FDIA very few national banks have failed" (App. A, *infra*, p. 27a). The FDIC informs us that more than 500 federally-insured banks have failed since passage of the Federal Deposit Insurance Act. Of these, 101 were national banks.

alone would require the FDIC to pay more than \$36 million to the creditors of the Designated Group.⁶ The FDIC has excluded some standby letters of credit from purchase and assumption transactions concerning failed banks in New York, Ohio, and Wisconsin; the holders of these letters have filed suit against the FDIC. More than 40 other cases in the lower courts involve the FDIC's authority to exclude liabilities from purchase and assumption transactions.

The holding here makes it attractive for bank insiders to guarantee their own debts with their banks' credit, and so the question presented is likely to be of still greater importance in years to come. This decade has seen a dramatic increase in the use of standby letters of credit; the Chairman of the Senate Committee on Banking and Currency has predicted that there will be approximately \$100 billion in standby letters of credit and similar guarantees in the near future. 121 Cong. Rec. 28854 (1975) (Sen. Proxmire). Because the issue in the case is clearly drawn, the Court is unlikely to be assisted by further appellate decisions. It should grant review now so that the FDIC may learn, as quickly as possible, its duties in purchase and assumption transactions.

2. No one disagrees with the FDIC's decision here to arrange a purchase and assumption transaction. The purchase and assumption protected the depositors

⁶ The present case involves some \$11 million; other creditors of the Designated Group have brought suits whose outcomes will be controlled by the result in this case.

and borrowers of USNB and was far preferable to the alternative of liquidating the Bank and reimbursing depositors (perhaps many years later) for part of their losses. As the court of appeals observed, "[t]he consequences of liquidation were awesome" (App. A, *infra*, p. 6a). All 62 of USNB's offices would have been closed, all checks drawn on its accounts would have been dishonored, all borrowers' credit would have been extinguished, and all funds deposited in the bank would have been effectively frozen until FDIC could arrange for the insurance to be paid. Even then, as the court of appeals noted, "[i]nsured depositors would receive only a maximum of \$20,000 and a large percentage of the deposits were over that amount" (*ibid.*). Congress authorized the FDIC to arrange purchases and assumptions by going banks in order to avoid such disruptions and losses. Here, as the court of appeals observed, the FDIC's efforts allowed USNB to be taken over by the Crocker National Bank with no interruption in services and not a penny lost to any customer of USNB (*id.* at 9a).

It was clear from the outset of FDIC's efforts, however, that no bank would assume the huge contingent liability represented by the standby letters of credit USNB had issued to back up the loans of the Designated Group. USNB's liability on these letters depended on whether the Designated Group could (or would) make good its debts. But these persons were considered unreliable, and their personal fortunes depended substantially on the status of USNB. With the collapse of the Bank, they were thought

likely to default on their obligations to respondents, and because their assets were "of questionable value," there was a substantial likelihood that they would not meet their obligations (App. A, *infra*, p. 8a).⁹ Prospective purchasers therefore informed the FDIC that they would not bid on USNB's assets unless the FDIC either excluded the Designated Group's obligations from the transaction or guaranteed those obligations (*id.* at 8a-9a). The FDIC chose the former course, and the district court held that this was a reasonable decision (App. B, *infra*, pp. 47a-48a). The court of appeals did not question the finding that the decision was reasonable; it held, instead, that the decision was unlawful without regard to its reasonableness.

3. The court of appeals concluded that Section 1823(e) does not authorize the FDIC to conduct purchase and assumption arrangements unless it also complies with the requirements that 12 U.S.C. 91 and 194 place on receivers (App. A, *infra*, pp. 22a-23a). The court's error lies in its failure to recognize the broad authority Congress granted to the FDIC in Section 1823(e).¹⁰

⁹ In fact, members of the Designated Group did subsequently default on their loans. App. A, *infra*, p. 18a.

¹⁰ In a similar case, the Supreme Judicial Court of Massachusetts held that, in a purchase and assumption transaction under the predecessor of 12 U.S.C. 1823(e), the acquiring bank need not assume all the liabilities of the failing bank. *Thomas P. Nichols & Son Co. v. National City Bank*, 315 Mass. 421, 48 N.E. 2d 49, 53, certiorari denied, 320 U.S. 742. In that case the plaintiff creditor was excluded from the pur-

Nothing on the face of either Section 91 or Section 194 supports the court of appeals' conclusion. Section 194 applies only to the Comptroller, who "shall make a ratable dividend of the money paid over to him" by the bank's receiver. Its substantive rule applies to the FDIC only to the limited extent provided by Section 1821(d), which states that the FDIC shall comply "with the provisions of law relating to the liquidation of closed national banks *except* as herein otherwise provided" (emphasis added). Section 91, moreover, deals only with "payments of money * * * made with a view to prevent the application of [the bank's] assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another * * *." A purchase and assumption transaction arranged by the FDIC under Section 1823(e) could not "prevent" the proper application of funds, especially if our construction of Section 194 is correct. Moreover, the principal "payment of money" in a Section 1823(e) purchase and assumption is the payment of money out of the FDIC's insurance fund; it is quite improbable that Section 91 has anything to do with the distribution of the FDIC's insurance fund.

chase and assumption in the mistaken belief that a local court had dismissed his claim. Nonetheless, the Massachusetts court held that the FDIC's power to arrange purchase and assumption transactions "upon such terms and conditions as it may determine" precluded relief to the creditor, and that that statute overrode whatever rights the creditor might have to a "ratable distribution of the assets." See also *Federal Deposit Insurance Corp. v. Cloonan*, 165 Kan. 68, 193 P.2d 656, 672.

This is not to say that 12 U.S.C. 194 has no application to the assets of failed banks that are the subject of a purchase and assumption transaction; that section comes into play after the purchase and assumption is completed. Section 194 requires a ratable dividend of the "money" and the "proceeds of the assets" of the failed bank—the distribution which the receiver makes after having liquidated into cash whatever assets remain.¹¹ Section 194 could not apply to the assets and liabilities that are transferred to the going bank, because they are not reduced to "money."¹²

Section 194's requirement that ratable distributions be made from the "proceeds of the assets" of the failed bank bears out our position. The money that the FDIC put into the transaction was not in any sense an "asset" of USNB; it therefore cannot be distributed, ratably or otherwise, under Section 194. The fact that the statutory infusion of money to protect the bank's depositors enables them to be paid at 100 percent does not make the distribution of the bank's assets non-ratable.

Sections 91 and 194 thus could require the FDIC to guarantee all of the failed bank's liabilities only if

¹¹ Because Section 1823(e) gives the FDIC a first lien on these assets, it may turn out that a ratable distribution inures entirely to the benefit of the FDIC's insurance fund.

¹² Of course, if there is no purchase and assumption, but merely a liquidation, Section 194 comes into play when the assets in the failed bank's "estate" are reduced to money and distributed.

something in their legislative history, or the history of Section 1823(e), plainly required that result. The legislative history, however, does not support the court of appeals' position.

4. Sections 91 and 194 were enacted in 1864 as part of the National Bank Act. Their legislative history does not discuss how, if at all, they affect the role of the FDIC, because the FDIC did not then exist, and neither did purchase and assumption transactions. Purchase and assumption transactions became possible only in 1935, when Congress enacted the Federal Deposit Insurance Corporation Act; 12 U.S.C. 1823(e) authorized the FDIC, as receiver, to borrow money from itself and to use these funds to enable a going bank to purchase a failed bank.¹³

Congress thus gave the FDIC in 1935 a power that no ordinary receiver ever had.¹⁴ In Section 1823(e)

¹³ Although the court of appeals was technically correct in stating that the Federal Deposit Insurance Act (FDIA) "did not create the concept of a purchase and assumption agreement" (App. A, *infra*, p. 23a), pre-FDIA "purchase and assumption agreements" were simply cases where a new bank was organized to take over the assets and liabilities of a failed bank. See *Gockstetter v. Williams*, 9 F.2d 354, 355 (C.A. 9); *Hulse v. Argetsinger*, 18 F.2d 944 (C.A. 2); *Ex Parte Moore*, 6 F.2d 905, 906 (E.D. S.C.). In none of those cases could the new bank fully protect the depositors of the old, because the new bank began with only the assets of the failed bank. The FDIA did "create the concept" of a receiver able to protect all depositors by using the assets of a quasi-public insurance fund to induce a going bank to assume both the assets and the liabilities of an insolvent bank.

¹⁴ This authority was originally temporary, 49 Stat. 699, 49 Stat. 1237, and was made permanent in 1938, 52 Stat. 767.

Congress authorized the FDIC to use the deposit insurance fund to arrange purchase and assumption transactions "upon such terms and conditions as it may determine." If Congress had intended the FDIC's authority to be subject to the requirements that Sections 91 and 194 placed on the Comptroller and receivers in liquidations, it would not have used such broad language in Section 1823(e). Nor would it have provided, as it did, that the FDIC must "wind up the affairs of [a closed national] bank in conformity with the provisions of law relating to the liquidation of closed national banks, *except as herein otherwise provided*" (12 U.S.C. 1821(d); emphasis added).

In the House debate on the bill that made the statute permanent, Representative Williams, a member of the House Banking and Currency Committee, testified that Section 1823(e) would allow the FDIC to do what it has done here—to discriminate between the "good" and "bad" parts of a failing bank, and to transfer only the good parts to the acquiring bank:

This provision permits the [FDIC] to lift from * * * a [weak] bank, while it is still a going concern, its bad assets either by a loan or by purchase and to liquidate those assets, while the good assets may be transferred to another insured bank. This will permit the liquidation of the bad assets and save the good assets from going through the wringer. Under this method only the bad assets are taken over by the [FDIC] and handled and adjusted by its liquidating agent, while the good assets pass to another

bank. * * * [U]nder this procedure there will be less loss to the [FDIC] and to the community and much of the inconvenience, disturbance, anxiety, apprehension, and all those attendant evils resulting from a general bank failure and liquidation will be avoided. [83 Cong. Rec. 7191 (1938).]

Indeed, by providing FDIC with a lien on the assets remaining in the bank's estate controlled by the receiver, Section 1823(e) recognizes that purchase and assumption transactions need not include all the failed bank's assets and liabilities; there is no reason to provide for the subordination of other creditors to the FDIC if all of the failed bank's assets must be purchased, and all of its liabilities assumed, by the acquiring bank.

The reason that 1823(e) allows the FDIC to "save [only] the good assets from going through the wringer" of liquidation is well illustrated by this case. Respondents took a banking risk that USNB would pay the debts of Smith and his associates, if they themselves did not. Respondents relied on USNB apparently because they doubted the creditworthiness of the Designated Group. Once USNB failed, its promise to pay became of only limited value; if USNB's assets had been liquidated, it is most unlikely that respondents would have received full payment, or anything close to it, on their contingent claims. The holding of the court of appeals means that, as the price of arranging a purchase and assumption transaction to protect USNB's depositors, the FDIC was required

to ensure payment in full of any claims respondents might make. In other words, the FDIC was required to eliminate the banking risk respondents took in making their loans to the Designated Group.

But the FDIC's deposit insurance fund is designed to protect depositors of, and the communities served by, banks that fail. See 12 U.S.C. 1821(a). It is not designed to protect loans and guarantees made by the failed bank, and it is certainly not designed to protect loans made by other banks such as respondents, thus insulating professional bankers from the business risks which they assumed in lending money. By requiring the FDIC to guarantee the payment of respondents' loans, the court of appeals has forced the FDIC to choose between liquidating failed banks, thus causing loss to the depositors, and arranging purchase and assumption transactions that eliminate the commercial risk voluntarily assumed by other banks. Section 1823(e) was designed to free the FDIC from this choice between unacceptable alternatives.

The court of appeals thought that its decision left the FDIC free to exclude some assets and liabilities from purchase and assumption transactions (App. A, *infra*, 25a; emphasis added):

This is not to say that every purchase and assumption agreement must include every creditor in order to be valid. If the purchase leaves sufficient assets in the receivership to allow distribution to unassumed creditors *equal to that undertaken by the acquiring bank as to the*

creditors it has accepted, distribution still could be ratable. See *White v. Knox*, 111 U.S. 784, 785 (1884). The FDIC may prefer to take this chance. It must, however, stand ready to render the distribution ratable—to supplement the remaining assets should they fall short and to surrender its lien when necessary. [Emphasis added.]

This is plainly no solution at all. If the depositors are to be fully protected,¹⁵ then the "distribution * * * undertaken by the acquiring bank" to those depositors is 100 percent. But the very fact that the bank has failed demonstrates that there are not sufficient assets to allow full distribution both to depositors and other creditors.¹⁶ Thus, the court of appeals' "solution" offers no way out of the dilemma it has created. Under the court's decision, the FDIC can protect the accounts of depositors only to the extent it protects the loans of professional bankers.

¹⁵ Depositors are creditors of the bank holding their deposits. See, *e.g.*, 12 U.S.C. 1821(d) (FDIC as receiver shall pay to "depositors and other creditors" amounts available for distribution); 12 U.S.C. 1823(e) (FDIC loans are subordinate to "rights of depositors and other creditors").

¹⁶ *White v. Knox*, 111 U.S. 784, cited by the court of appeals, sheds little light on the problem. In that case the Comptroller liquidated a national bank and paid all creditors a dividend of 65 percent of their claims as of the date of failure. White's claim on the date of failure was \$60,000, but it was not reduced to judgment against the defunct bank until eight years later; the court included interest from the date of the claim and thus entered judgment in favor of White for \$104,523. This Court held that the Comptroller must pay White only 65 percent of \$60,000.

This is what Congress intended to avoid in authorizing the FDIC to arrange purchase and assumption transactions.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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APPENDIX A

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

[Filed Apr. 6, 1978]

No. 77-2090

FIRST EMPIRE BANK—NEW YORK (by its successor in interest) MANUFACTURERS & TRADERS TRUST CO. of Buffalo, New York, a New York banking corporation, and SOCIETE GENERALE, a French banking corporation, Plaintiffs-Appellants

vs.

FEDERAL DEPOSIT INSURANCE CORPORATION and FEDERAL DEPOSIT INSURANCE CORPORATION AS RECEIVER OF UNITED STATES NATIONAL BANK, Defendants-Appellees

No. 77-2147

FEDERAL DEPOSIT INSURANCE CORPORATION and FEDERAL DEPOSIT INSURANCE CORPORATION AS RECEIVER OF UNITED STATES NATIONAL BANK, Counterclaimants-Cross-Appellants

vs.

FIRST EMPIRE BANK—NEW YORK and
SOCIETE GENERALE,
Counterdefendants-Cross-Appellees

OPINION

On Appeal from the United States District Court
for the Southern District of California

Before: BROWNING and MERRILL, Circuit Judges,
and HARPER,* District Judge

MERRILL, Circuit Judge:

This case arises out of the insolvency and receivership of the United States National Bank of San Diego (USNB). The Federal Deposit Insurance Corporation (FDIC), as Receiver, entered into an agreement with Crocker National Bank for purchase by Crocker of selected assets of USNB and assumption by Crocker of certain of the bank's obligations, including deposits. This suit was brought by creditors of USNB, whose claims had not been assumed by Crocker. They contend that Crocker's assumption, carrying with it assurance of payment in full of the claims assumed, amounted to a distribution by the Receiver in which the plaintiffs were entitled by law to share ratably. Accordingly they seek to recover from the FDIC the amount of their claims in full. They here appeal from judgment rendered by the district court in favor of the FDIC.

Appellants' claims arise out of standby letters of credit issued by USNB in connection with loans made by appellants to customers of USNB. The

* Honorable Roy W. Harper, Senior United States District Judge for the Eastern District of Missouri, sitting by designation.

FDIC contends that these claims were contingent, and were not debts of USNB at the time of its insolvency or at the time it was placed in receivership. The FDIC contends that for that reason the claims were not provable in the receivership. It cross appeals from judgment of the district court holding the claims to be provable.

The facts bearing on the appeal and cross appeal will be more fully discussed below.

I. FACTS

A. *The FDIC and Insolvent Banks*

The FDIC, under the Federal Deposit Insurance Act (FDIA), is given the duty of insuring to \$40,000 each deposit made in national banks that are members of the Federal Reserve System, 12 U.S.C. §§ 1811, 1813(m), 1821(a), (f). From assessments paid by the insured banks an insurance fund has been created, 12 U.S.C. § 1821(a), from which the FDIC meets its responsibilities as insurer. In this respect, § 1821(f) provides in part:

"Whenever an insured bank shall have been closed on account of inability to meet the demands of its depositors, payment of the insured deposits in such bank shall be made by the Corporation as soon as possible * * * either (1) by cash or (2) by making available to each depositor a transferred deposit in a new bank in the same community or in another insured bank in an amount equal to the insured deposit of such depositor."

It is the Comptroller of the Currency who, under the National Bank Act, is empowered to place a national bank in receivership. This he may do whenever he "shall become satisfied of the insolvency" of a bank. 12 U.S.C. § 191. Since enactment of the FDIA the receiver appointed by the Comptroller for national banks must be the FDIC. 12 U.S.C. § 1821 (c).

This places the FDIC in the unusual position of acting in two capacities with respect to national banks closed by the Comptroller: in its corporate capacity, as insurer of deposits (in which respect we, as does the FDIA, shall refer to the FDIC as "the Corporation"), and in its capacity as receiver (in which respect we shall refer to it as "the Receiver"). This duality requires the FDIC frequently to deal with itself, *e.g.*, to lend or sell to itself. The prayer of the complaint in this case seeks to require the FDIC as the Corporation to stand good for acts of the FDIC as the Receiver.

Under the FDIA the Corporation, through its board of directors, is authorized to take action to assist a failing bank with the hope that it may be able to avert the bank's closure and the drastic economic effect that closure might have on the community served by the bank. 12 U.S.C. § 1823(c) and (e). One form of relief often resorted to for this purpose is the purchase and assumption agreement. By such an agreement the Corporation encourages the failing bank to agree to a takeover of its business by a sound bank. This involves an assumption by the

acquiring bank of the failing bank's deposit and commercial obligations and a purchase of its assets. Where the assets are found to be less in value than the outstanding obligations, the Corporation is authorized by the FDIA to lend to the failing bank such a sum of money, to be passed on to the acquiring bank, as would bring the assumption and purchase into balance. 12 U.S.C. § 1823(c). The Corporation may take a lien on any assets remaining in the receivership to secure its loan. *Id.*

The Corporation realistically recognizes that it may not come out in the black on such a transaction. However, the question faced by the Corporation's board of directors is whether the arrangement is likely to be less costly than the bank's closure, which otherwise is the probable result, with the expense to the Corporation of compensating the insured depositors which would necessarily follow. 12 U.S.C. § 1823(e); see Bransilver, *Failing Banks: FDIC's Options and Constraints*, 27 Ad.L.Rev. 327 (1975).

The purchase and assumption agreement also can be resorted to by a bank already failed and in receivership, in which case the Corporation deals not with the failing bank but with itself as Receiver. This is what occurred in the case of USNB.

B. *The Insolvency of USNB*

In August, 1973, the Comptroller advised the FDIC that USNB was in poor financial condition and might have to be closed. The FDIC was provided with examination reports of USNB and other financial

information available through the Comptroller's office. After analyzing the financial information, and information regarding the control of USNB, the FDIC decided that it had two relevant alternatives under the Act: (1) it could simply wait until USNB was closed by the Comptroller, and then pay the insured depositors up to the then \$20,000 statutory limit and liquidate the bank; or (2) it could attempt to find a bank to purchase USNB's assets and assume its liabilities.

The consequences of liquidation were awesome. All of USNB's sixty-two offices, located throughout five southern California counties, would have to be closed and the value of uninterrupted operation of the offices would be lost. All checks drawn on USNB accounts would have to be dishonored, causing harm not only to the account holders but also to those persons to whom the account holders had written checks. The accounts of over 300,000 depositors in USNB would have to be held in suspense for a time long enough to permit the FDIC to compile records, offset the deposits with the liabilities, 12 U.S.C. § 1813(m), and pay the insurance, 12 U.S.C. § 1821 (f). Insured depositors would receive only a maximum of \$20,000, and a large percentage of the deposits were over that amount. Depositors and creditors would then receive only distributions from the liquidation of USNB's assets over a lengthy period of years. USNB had approximately one billion, two hundred and fifty million dollars in book values of assets and liabilities. It had deposits of

\$930 million. It had a trust department with assets under management of approximately \$156 million. It had 344,000 separate deposit accounts. Approximately \$300 million of those deposits were not insured. Innumerable legitimate borrowers were relying on USNB as a continuing source of credit to finance their businesses.

Faced with these consequences, the Board of Directors of the FDIC decided to attempt to find another bank to participate in a purchase and assumption transaction on such terms as would reduce the risk of loss to the Corporation.

It was first necessary to formulate the transaction in such a manner as would prove attractive to interested banks, so that competitive bidding among such banks would minimize the losses of the FDIC. To this end representatives of qualified and interested banks were invited to join with the Corporation in a discussion designed to fix the conditions of a purchase and assumption agreement. It became immediately apparent that certain assets and liabilities of USNB were not readily acceptable to the banks. These were assets and liabilities connected with the bank's controlling shareholder, C. Arnholt Smith, and certain USNB shareholders and companies associated with him. The banking transactions of the members of this group, referred to by the FDIC as the "Designated Group," were regarded as suspect. Many interested persons attributed USNB's failure in large part either to mismanagement by the Designated Group or to their misuse of official power for per-

sonal gain, and charges were then under investigation by the Securities and Exchange Commission and the Internal Revenue Service. The members of the Designated Group individually were substantially indebted to USNB and the bank had issued standby letters of credit on their behalf to other banks that had lent money to group members. The consensus of the banks consulted by the Corporation was that the financial status of the Designated Group members was such that their obligations to USNB were of questionable value as assets, and that the assumption of liability on the standby letters of credit presented an unacceptable banking risk. Accordingly, the banks rejected such obligations as purchasable assets unless the Corporation would guarantee their value; they refused to assume the letters of credit as obligations unless in each case they had from the Corporation a guarantee of the obligation of the account party to the creditor bank as an offsetting asset.

The Corporation, faced with this ultimatum, refused to guarantee the value of these obligations.¹ It did not question the legal enforceability of the letters against USNB. However, it did not regard this as the controlling consideration. Instead it focused on the desirability of permitting the account parties to have their debts to the creditor banks paid

¹ The Corporation is authorized to make such a guarantee under 12 U.S.C. § 1823 (e), which provides that "the Corporation * * * may guarantee any other insured bank against loss by reason of its assuming the liabilities and purchasing the assets of an open or closed insured bank."

out of the Corporation's jealously guarded deposit insurance fund. It felt that by guaranteeing the letters of credit it would be using the deposit insurance fund to make good "tainted" transactions of the Designated Group. Consequently, the purchase and assumption agreement as ultimately formulated did not include as purchased assets the obligations of members of the Designated Group or, as assumed obligations, the standby letters of credit issued to creditors of the group members. The transaction thus formulated was offered to the banks for competitive bid.

On October 18, 1973, USNB was closed by the Comptroller and the FDIC was appointed Receiver. Crocker National Bank, bidding \$89.5 million for the value of USNB as a going concern, emerged as the acquiring bank and the following morning all USNB facilities, except its Nassau, Bahamas office, opened as branches of Crocker National Bank.

To implement the purchase and assumption agreement the Corporation lent to the Receiver the sum of \$128,780,000 representing the difference between the amount of obligations assumed by Crocker and the value of the assets purchased, less the premium paid. To secure this loan the Corporation took a lien, prior to the claims of the remaining creditors of the receivership, on the unpurchased assets remaining in the receivership. The sum so lent was passed to Crocker by the Receiver along with the purchased assets.

II. CROSS APPEAL OF FDIC

The FDIC has cross appealed from the rejection of its counterclaim against appellants and from the holding that appellants' claims were provable against the receivership estate. We consider this issue first because if the FDIC prevails and the letters are held not to be provable, appellants are without standing to advance the contentions they make in their appeal.

When USNB closed, the Receiver made demands upon appellants for deposits of USNB held by the appellant banks. Appellants refused to meet the Receiver's demands and retained the deposits to offset them against the amounts owed to them by USNB on the standby letters of credit. The FDIC filed a counterclaim in this action for the return of the deposits. The district court, holding the letters of credit to be provable, allowed appellants to set off their obligations against the amounts due on the letters of credit and rejected the counterclaim. The Receiver contends that this was error. It seeks not only to avoid liability on the letters of credit but also to recover from appellants the sums owed to USNB on the offset claims.

A. Nature of Letters of Credit

Preliminarily a word should be said with respect to the nature of the standby letter of credit—the commercial instrument upon which appellants' claims are based.

The Receiver has acknowledged that some letters of credit issued by USNB did create provable claims and included these letters in the obligations assumed by Crocker in the purchase and assumption agreement. These were primarily traditional or commercial letters of credit.² This type of instrument developed as a means of facilitating international trade between distant buyers and sellers not commercially acquainted with each other.

“Stripped to its essentials, the transaction runs as follows: the buyer arranges for a bank—whose credit the seller will accept—to issue a letter of credit in which the bank agrees to pay drafts drawn on it by the seller if, but only if, such drafts are accompanied by specified documents, such as bills of lading or air freight receipts, representing title to the goods that are the subject matter of the transaction between buyer and seller. The bank undertakes this obligation for a specified period of time.”

Verkuil, *Bank Solvency and Guaranty Letters of Credit*, 25 Stan.L.Rev. 716, 718 (1973) (hereinafter “Verkuil”).

This letter of credit creates an absolute, independent obligation and payment must be made upon

² Letters of credit of this type were the subject of an earlier action against the Receiver in the USNB receivership that ultimately reached this court. *International Westminster Bank, Ltd. v. FDIC*, 509 F.2d 641 (9th Cir. 1975). The questions presented by this appeal were not reached in that case which was concerned only with whether the complaint adequately alleged equity jurisdiction to justify the injunctive and declaratory relief sought. 509 F.2d at 644-45.

presentation of the proper documents regardless of any dispute between the buyer and seller concerning their agreement, such as a dispute over the quality of the goods delivered. See, Battaile, *Guaranty Letters of Credit: Problems and Possibilities*, 16 Ariz. L.Rev. 823, 825 (1974) (hereinafter "Battaile"); *Asociacion de Azucareros de Guatemala v. United States Nat'l Bank of Oregon*, 423 F.2d 638, 641 (9th Cir. 1970).

In recent years instruments operating as letters of credit (in that they operate to create an absolute obligation upon presentation of specified documents) and termed "standby" to distinguish them from the traditional letters of credit have been used as security devices in a variety of contexts outside the traditional area of the international sale of goods. They have been used to insure construction loans, as quasi-performance bonds, to support the issuance of commercial paper and to secure the performance of purely monetary obligations such as those involved in this case. See Battaile, *supra* at 822-26; Verkuil, *supra* at 717, 721-22. Standby letters are convenient and inexpensive and are being adapted to many uses at this time. See Verkuil, *supra* at 717. The principal difference between the traditional letter of credit and these newer standby letters is that "whereas in the classical setting, the letter of credit contemplates payment upon performance, 'the standby credit,' * * * 'contemplates payment upon failure to perform.'" Katskee, *The Standby Letter of Credit Debate—the Case for Congressional Resolution*, 92

Banking L.J. 697, 699 (1975) (hereinafter "Katskee").

This has created an awkward situation for national banks, since the standby letter of credit possesses more of the characteristics of a guarantee and national banks are not authorized to enter into guarantees. See Katskee, *supra* at 712-14; Harfield, *The Standby Letter of Credit Debate*, 94 Banking L.J. 293, 301-03 (1977). No contention is made here, however, that issuance of the letters of credit in question was ultra vires. The Receiver has not asserted that defense and the Comptroller appears to have chosen instead to recognize the widespread bank use and commercial usefulness of the instrument and to attempt, by regulation, to eliminate the abuses which the failure of USNB has demonstrated can result from unregulated and excessive use. FDIC Reply Brief at 5-6; see, e.g., 12 C.F.R. § 7.7016 (1977).

B. *Provability of Standby Letters of Credit*

The Receiver contends, nevertheless, that standby letters of credit, whether ultra vires or not, are not provable in a national bank receivership, since, it asserts, claims against the receiver of a national bank are not provable if they were contingent on the date of the bank's insolvency. Although the case law is quite limited, where commentators have made such statements of the law, e.g., 9 C.J.S. *Banks and Banking* § 755, they are found to rest on cases involving a lessor of property leased to the bank who is assert-

ing a claim against the receiver to recover liquidated damages for loss of future rent.

Kennedy v. Boston-Continental Nat'l Bank, 84 F.2d 592 (1st Cir. 1936), *cert. dismissed*, 300 U.S. 684 (1937), was such a case. There the lessor, following default by the national bank lessee, sought to exercise an option given him by the lease to obtain as liquidated damages the difference between the fair rental value of the property for the balance of the lease and the rental provided by the lease. The court held the claim not provable, relying on contract principles which reasoned that exercise of the option by the lessor created a new contract which came into being at the time of re-entry by the lessor. This court has followed *Kennedy* in a case also dealing with an exercise of option to obtain liquidated damages for loss of future rent, *Argonaut Savings and Loan Ass'n v. FDIC*, 392 F.2d 195, 197 (9th Cir.), *cert. denied*, 393 U.S. 839 (1968). *Accord*, *FDIC v. Grella*, 553 F.2d 258, 262 (2d Cir. 1977).

Although these cases use broad language, indicating that the bank's liability on any claim must have accrued and be unconditionally fixed at the date of insolvency, they are, by virtue of their dependence on the "new contract" principle, distinguishable from cases not dealing with lease options exercised after insolvency. The claims here are based on letters of credit that were in existence before insolvency and are not dependent on any new contractual obligations arising later.

We note that at the time *Kennedy* was decided claims for future rent in bankruptcy were handled in a manner different from that by which other contingent obligations were handled. Although contingent contract liabilities were provable in bankruptcy, "the courts stopped short of extending the same liberality of view to claims based on leases." 3A Collier on Bankruptcy § 63.32[3] at 1927. This "remnant of medieval theory" is the basis for the statement in *Kennedy* that exercise of the right to re-entry amounted to creation of a new contract arising after insolvency. *Id.* at 1927-28. Shortly after the decision in *Kennedy*, the bankruptcy rules were liberalized to allow proof of a landlord's claim, although leases remained (and still remain) in a category apart from other contract claims, even in the present bankruptcy rules. *See id.* at § 63.31[1] at 1915-16, § 63.32[5] at 1931-32; 11 U.S.C. § 103(a)(9).

The dissenting judge in *Kennedy* noted that the allowance of the claim "depends on whether the equity rule or bankruptcy rule of provability should be followed" in a national bank's receivership. 84 F.2d at 598. His statement and the cases cited in the opinion indicate that the majority was relying on the now outdated bankruptcy rules in reaching its decision that the claims were not provable.

We conclude that the holdings of *Kennedy* and *Argonaut* should be limited to cases involving leases and loss of future rent and should not be extended to other contingent obligations. To follow those cases here would amount to extending into new areas a

rule that now appears to be outmoded, based as it is on a bankruptcy rule that today has been repealed in favor of the contrary equity rule.

Although the authority against the provability of these letters is thus distinguishable, there is little positive authority to support a holding that they are provable in national bank receiverships. There is authority holding such claims provable in general equity receiverships and in bankruptcy, as we shall discuss, but the only case dealing with the question in the context of national bank receiverships is *Pinckney v. Wylie*, 86 F.2d 541 (5th Cir. 1936). There a claim based on a bank's obligation as a surety for another's debt was asserted against a receiver of a national bank. The principal issue was whether the claimant was entitled to a ratable distribution based on the full amount of the debt or on the amount of the debt after crediting the proceeds from the sale of the security for the loan. 86 F.2d at 542. In deciding the amount of the claim, the court necessarily recognized that a claim based on a bank's obligation as surety or guarantor is provable, although it did not discuss the issue.

The result in *Pinckney* is consistent with the bankruptcy rules and equitable receivership principles governing the provability of contingent claims. Claims based on surety or guarantee obligations of a bankrupt are clearly provable as contingent contract obligations, 11 U.S.C. § 103(a)(8). 3A Collier on Bankruptcy, § 63.19 at 1876. Even before the bankruptcy statute was amended to specifically state that con-

tingent contract claims are provable, courts held suretyship and guarantee claims provable, stating "even though not due until after the year allowed for proof of claims, if proved in time, such a claim may be liquidated as are other unmatured claims." *Maynard v. Elliott*, 283 U.S. 273, 279 (1931) (and see cases cited therein).

This bankruptcy rule of provability seems consistent with the principles governing equitable receiverships. Under equitable principles the court must consider:

"* * * on the one hand, the substantial right of all creditors to share in their debtor's property, and, on the other, the necessity for expeditious administration and, giving due consideration to both, must make rules which are practicable as well as equitable."

Penn. Steel Co. v. New York City Ry. Co., 198 F. 721, 738 (2d Cir. 1912). The court in *Penn. Steel* divided all claims into three classes:

"(1) Claims which at the commencement of proceedings furnish a present cause of action;

(2) Claims which at that time are certain but which are not matured;

(3) Claims which are contingent."

Id. at 738. The first two classes are clearly provable but the third class of contingent claims must be divided into two subclasses:

"(1) Claims of which the worth or amount can be determined by recognized methods of com-

putation at a time consistent with the expeditious settlement of the estates;

(2) Claims which are so uncertain that their worth cannot be so ascertained."

Id. at 739-40. The latter class cannot be proved, but the claims in the former class are provable. *Id.*

The court in *Penn. Steel* found no equitable reason why the time of appointment of the receiver should determine the provability of claims, and held that:

"Claims which when presented within the time limited by the court for their presentation are certain or are capable of being made certain by recognized methods of computation, should be allowed. Claims which are not then certain should be disallowed because they afford no basis for making dividends. *But there is no equitable reason why claims which are certain when presented and which are presented in time should have been certain at some arbitrary anterior period.*"

Id. at 741-42 (emphasis supplied). We agree with that statement.

The claims at issue here would be considered provable under these equitable principles because the liability on the standby letters of credit was absolute and certain in amount when this suit was filed against the Receiver. By that time, the principals had defaulted on the primary loan obligations. The claims against the Receiver were made in a timely manner, well before any distribution of the assets of the receivership, other than the distribution made through the purchase and assumption agreement.

Finally we note that the Receiver seems already to have acted upon the assumption that standby letters of credit are, in principle, provable. Some such instruments were actually assumed by Crocker with FDIC approval, and thus those creditors were assured payment in full. These were letters where Crocker was willing to accept the obligation of the account party to the creditor bank as in offsetting asset. Thus, it was not the "taint" of membership in the Designated Group that rendered the letters of appellants unacceptable to Crocker. It was the fact that the obligation was certain to accrue. It was in such cases that Crocker insisted upon the FDIC's guarantee.

We conclude that the claims of appellants were provable in face amount in the receivership.

III. APPEAL OF FIRST EMPIRE BANK AND SOCIETE GENERALE

A. *Ratable Distribution Under the NBA*

Appellants contend that the purchase and assumption agreement amounted to a preference of the creditors whose obligations were assumed, contrary to the provisions of the National Banking Act (NBA), 12 U.S.C. § 91, which provides in part: "All payments of money * * * made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in a manner prescribed by this chapter, or with a view to the preference of one creditor to another * * * shall be utterly null and void * * *."

Appellants further contend that the purchase and assumption agreement amounted to a distribution to those whose claims were assumed by Crocker, and that such distribution was not "ratable" as required by the NBA, 12 U.S.C. § 194, which reads in part as follows:

"From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such association, the comptroller shall make a *ratable dividend* of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction * * *." (emphasis supplied).

Appellants contend that under the FDIA, §§ 91 and 194 of the NBA apply to the FDIC as Receiver. Section 1821(d) of the FDIA provides in part:

"Notwithstanding any other provision of law, it shall be the duty of the Corporation as such receiver * * * to wind up the affairs of such closed bank *in conformity with the provisions of law relating to the liquidation of closed national banks*, except as herein otherwise provided." (emphasis supplied).

The Receiver contends that § 91 does not apply to banks in receivership, but only to preclosure transactions. It contends that § 194 does not apply to it^a

^a The FDIC also suggests that since this was not the ordinary kind of distribution of assets in a receivership but a method of satisfying claims which is expressly authorized by

and that § 1821(d) excuses it from the provisions of § 194 when it is engaged in assisting in the takeover of a closed bank. It points out that the language of § 1821(d) (on which appellants rely as applying the NBA to the Receiver) contains an exception "except as herein otherwise provided." As provision to the contrary, the Receiver relies on § 1823(e), which explicitly authorizes the Corporation to make loans implementing purchase and assumption agreements and which provides in part:

"Whenever in the judgment of the Board of Directors such action will reduce the risk of a threatened loss to the Corporation and * * * will facilitate the sale of assets of an open or closed bank to and assumption of its liabilities by another insured bank, the Corporation may *upon such terms and conditions as it may determine*, make loans secured in whole or in part by assets of an open or closed insured bank, which loans may be in subordination to the rights of depositors and other creditors * * * [.] Any insured national bank or District bank, or the Corporation

the FDIA, the NBA requirement of ratable distribution should not apply. It contends that only those few assets remaining in the receivership are subject to the ratable distribution requirement. We cannot agree. It is the proceeds of a purchase of receivership assets that must be ratably distributed under § 194. Here receivership assets (including the cash borrowed from the Corporation) were sold in exchange for Crocker's assumption of debts. That assumption, then, as proceeds of the sale, constitutes a distribution of assets which must give ratable recognition to the rights of creditors of the receivership. *Ex parte Moore*, 6 F.2d 905, 909 (E.D.S.C. 1925); see *Gocksetter v. Williams*, 9 F.2d 354 (9th Cir. 1925).

as receiver thereof, is authorized to contract for such sales or loans and to pledge any assets of the bank to secure such loans." (emphasis supplied).

The FDIC contends that under this language, when engaged as the Corporation or as Receiver, in accomplishing a takeover by a purchase and assumption agreement, it is authorized to act upon such terms and conditions as it may determine without any restriction such as is imposed by § 91 or 194. It concedes that it must act "reasonably." It contends that in rejecting the claims of banks that were so unwise as to extend credit to members of the Designated Group on standby letters of credit issued by USNB, and in refusing to subject its deposit insurance fund to payment of sums owed by members of that group, it was acting reasonably.

The district court agreed that the FDIC had acted reasonably and held that the purchase and assumption agreement did not violate § 91 and § 194 of the NBA. No relevant authority has been cited to us and we have found none. Since passage of the FDIA very few national banks have failed, due, without doubt, to the efficient operations of the Comptroller and the FDIC. Court-made law is, accordingly, sparse. However, we are unable to accept the contentions of the FDIC.

In our judgment § 1823(e) cannot be read to excuse the FDIC as the Receiver from complying with the provisions of the NBA. The clause emphasized, upon which the Receiver relies, refers to the FDIC in

its corporate capacity. The terms and conditions it has reference to are those conditions of loans and sales that would, in the judgment of the board of directors, qualify the agreement as action that would "reduce the risk of loss or avert a threatened loss to the Corporation." The FDIC points to the final sentence of the first paragraph of § 1823(e), set forth above, as indicating that the subsection has the Receiver in mind throughout and that the emphasized clause thus should apply to acts of the Receiver. We do not so read it. That sentence serves to enable closed or failing banks to contract with the Corporation and includes in its enablement the FDIC as Receiver of such banks. Thus the Receiver is taken note of only in so far as to recognize that it can contract with the Corporation. It is not, however, excused from behaving like a receiver when it does so act.

The FDIA did not create the concept of a purchase and assumption agreement. Before the FDIC was created, receivers of insolvent banks had entered into purchase and assumption agreements under the provisions of the NBA authorizing receivers to deal with receivership assets: 12 U.S.C. §§ 1922, 194. *See, Gockstetter v. Williams*, 9 F.2d 354, 355-56 (9th Cir. 1925); *Ex parte Moore*, 6 F.2d 905, 906-07 (E.D. S.C. 1925); *Hulse v. Argetsinger*, 18 F.2d 944 (2d Cir. 1927). Congress in enacting the FDIA thus noted a pre-existing practice. We find nothing to suggest that in doing so Congress intended the FDIC to be free from the requirements of § 91 and § 194 by which prior receivers had been bound in the formulating and execution of agreements.

To accede to the FDIC's contentions would seriously undermine the policy firmly set forth in § 91 that some creditors are not to be preferred over others, and of § 194 that when distributions are made they shall be ratably made. Under its interpretation of the statutes, the FDIC could (subject only to its concession that it must act "reasonably," but without any apparent applicable standard), pick and choose which creditors should be preferred, or permit the acquiring bank to pick and choose.

In this case the extraordinary extent of the lack of equal treatment is emphasized by the fact that the unassumed creditors, left with only a claim against the undesirable assets of USNB remaining in the receivership, do not even have that questionable source of recovery unimpaired. They are subordinated to the lien of the Corporation to secure its loan of money to the Receiver, all of which went to Crocker to make possible the advantage to the assumed creditors. This lien would without doubt consume in full the remaining assets, leaving the unassumed creditors without any recovery whatsoever. Thus, even as to the remaining assets the assumed creditors would seem, indirectly, to have got there first and to have cut the remaining creditors out.

In our judgment it could not have been the congressional intent, upon balance, to have the fiscal integrity of the deposit insurance fund (which can be adequately protected by other more equitable means) outweigh the policy of equitable and ratable payment of creditors in this manner and to permit the FDIC,

whenever it felt its action to be reasonable and to serve to protect the deposit insurance fund against loss, to prefer some creditors over others—paying some in full while others received little or nothing.

This is not to say that every purchase and assumption agreement must include every creditor in order to be valid. If the purchase leaves sufficient assets in the receivership to allow distribution to unassumed creditors equal to that undertaken by the acquiring bank as to the creditors it has accepted, distribution still could be ratable. See *White v. Knox*, 111 U.S. 784, 785 (1884). The FDIC may prefer to take this chance. It must, however, stand ready to render the distribution ratable—to supplement the remaining assets should they fall short and to surrender its lien when necessary.

We conclude that the responsibility lies on the FDIC under § 194 to compensate appellants for its failure as Receiver to make distributions ratably. Had it insisted that these appellants be included in the purchase and assumption agreement as creditors with claims assumed by Crocker, as it should have done, it would then have had to satisfy Crocker by adding to the amount borrowed from the Corporation and paid to Crocker the full amount of the claims. That sum appellants are now entitled to receive from the FDIC.

B. Interest

The question here is whether appellants should recover interest upon their claims. The FDIC contends that to allow recovery of interest would be to permit

increase of the claims over their amounts at the time of receivership. It relies on *White v. Knox*, 111 U.S. 784 (1884). In that case a creditor recovered a judgment against a national bank after the bank was declared insolvent. The judgment included the amount of his claim with interest added to the date of judgment. The claimant sought a ratable distribution on the full amount of the judgment including interest, but the Comptroller refused to recognize interest added between the insolvency and the judgment and paid a ratable dividend only on the amount of the claim as of the date of insolvency. 111 U.S. at 785. The Supreme Court agreed with the Comptroller, holding that the claimant was only entitled to a ratable distribution based on the value of the claim on the date of insolvency, "because the dividends to the other creditors had been calculated in that way and he was entitled to what had been distributed to others during the pendency of his litigation." 111 U.S. at 786.[*]

The purpose of the rule disallowing interest accruing after insolvency is to lend support to the concept of ratable distribution: that ratable distribution should be made to the creditors on the basis of what was due to them at the time of the insolvency. However, a difference must be recognized between the case where interest accruing after insolvency is added to become a part of the claim itself and the case where interest is awarded in addition to the amount of the claim for failure of the receiver to pay the claim when it became due or to include the

[* See pp. 29a-30a, *infra*.]

claim in a distribution in which it was entitled ratably to share.

Noting this distinction, the Court in *Armstrong v. American Exchange Nat'l Bank*, 133 U.S. 433, 470 (1890) allowed interest on a claim from the date on which the distribution to the claimant should have been made. Similarly, in *Ticonic Nat'l Bank v. Sprague*, 303 U.S. 406 (1938), the Court held that:

"It is true that in the liquidation of national banks, dividends from the general funds on unsecured claims are made pro rata upon the amount of each claim as of the date of the insolvency * * * It is in order to assure equality among creditors as of the date of insolvency that interest accruing thereafter is not considered. *But interest is proper where the ideal of equality is served, and so a creditor whose claim has been erroneously disallowed is entitled on its allowance to interest on his dividends from the time a ratable amount was paid other creditors.*"

303 U.S. at 411 (emphasis supplied).

To be accorded the required equal treatment among creditors, appellants were entitled to a ratable dividend of 100 percent of the value of each letter of credit on the date each letter matured. Because such a ratable distribution was not made, appellants are entitled to recover the interest accruing on each letter from the date of its maturity, the dates on which the distribution would have been made had all the claims been ratably treated. *Ticonic Nat'l Bank v. Sprague, supra*, 303 U.S. at 411.

JUDGMENT

On the cross appeal of the FDIC, the judgment of the district court holding appellants' letters of credit to be provable claims in face amount is affirmed.

On the appeal of First Empire Bank and Societe Generale, the judgment of the district court is reversed and the case is remanded with instructions that judgment be entered in favor of each appellant in the amount of the face value of each USNB letter of credit held by it, plus interest from the dates of maturity, less the amount of any USNB deposit held by it.

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

[Filed Apr. 10, 1978]

No. 77-2090

FIRST EMPIRE BANK—NEW YORK, etc., et al.,
PLAINTIFFS-APPELLANTS

vs.

FEDERAL DEPOSIT INSURANCE CORPORATION, et al.,
DEFENDANTS-APPELLEES

No. 77-2147

FEDERAL DEPOSIT INSURANCE CORPORATION, et al.,
COUNTERCLAIMANTS-CROSS-APPELLANTS

vs.

FIRST EMPIRE BANK—NEW YORK, et al.,
COUNTERDEFENDANTS-CROSS-APPELLEES

ORDER

MERRILL, Circuit Judge:

The opinion herein, filed April 6, 1978, is hereby corrected as follows:

The quotation, lines 2-5, page 22 [p. 26a, *supra*] is to read:

"because the dividends to the other creditors had been calculated in that way, and all he was en-

30a

titled to was a share in the proceeds of the assets equal to what had been distributed to others during the pendency of his litigation."

/s/ Charles M. Merrill
Circuit Judge

31a

APPENDIX B

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

Civil No. 74-468-N

[Filed Mar. 18, 1977]

FIRST EMPIRE BANK—NEW YORK, et al.,
PLAINTIFFS

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, et al.,
DEFENDANTS

FEDERAL DEPOSIT INSURANCE CORPORATION,
as Receiver of United States National Bank,
COUNTERCLAIMANT

v.

FIRST EMPIRE BANK—NEW YORK, et al.,
COUNTERDEFENDANTS

FINDINGS OF FACT AND
CONCLUSIONS OF LAW

This case came on for trial on November 30, 1976, and the evidence concluded December 17, 1976, after which post trial briefs were filed. Gary J. Greenberg of Stroock, Stroock & Lavan appeared as counsel for plaintiff and counterclaim defendant FIRST EMPIRE BANK—NEW YORK and its successor-in-interest Manufacturers and Traders Trust Company

of Buffalo, New York ("FEB"). Don A. Proudfoot, Jr. of Graham & James appeared as counsel for plaintiff and counterclaim defendant SOCIETE GENERALE ("Sogen"). Charles A. Legge and Wilkes R. Morgan of Bronson, Bronson & McKinnon, and Richard R. Gore of Schall, Boudreau & Gore appeared as counsel for defendants and counterclaimants FEDERAL DEPOSIT INSURANCE CORPORATION ("FDIC") and FEDERAL DEPOSIT INSURANCE CORPORATION as receiver of United States National Bank ("Receiver").

After receiving evidence, both oral and documentary, considering the briefs and other records on file in this action, the admissions contained in the pretrial order, and taking judicial notice of the pleadings and records on file in the matter entitled *In Re the Liquidation of United States National Bank*, action number 73-445-N, now pending before this Court, and the Congressional hearings of the Senate Subcommittee on Banking dated November 27, 1973, etc., the Court makes the following Findings of Fact and Conclusions of Law:

FINDINGS OF FACT

1. FEB was, upon the commencement of this action, a New York banking corporation with its principal place of business in New York City, and having a branch in Paris, France. On January 1, 1976, it was merged into the Manufacturers and Traders Trust Company of Buffalo, New York (a New York banking corporation), which prosecutes this action as successor-in-interest to FEB. Sogen is a French

banking corporation with its principal place of business in Paris, France, having a branch in London, England.

2. FDIC is an agency of the United States government organized and existing under and by virtue of an act of Congress Title 12 U.S.C. §§ 1811-1831.

3. Receiver was appointed to such position on October 18, 1973, when the Comptroller of the Currency ("Comptroller") declared United States National Bank (of San Diego, California) ("USNB") insolvent (12 U.S.C. § 1821[c]).

4. Until October 18, 1973, USNB was a national banking association with its principal place of business in San Diego, California.

5. On October 18, 1973, at 3:00 p.m. (P.D.T.), the Comptroller declared USNB to be insolvent and appointed FDIC the Receiver.

6. Shortly after 3:00 p.m., October 18, 1973, the Receiver, through the FDIC board of directors (all of whom were present in San Francisco), called for bids upon a predrafted Purchase and Assumption Agreement. By the terms of the agreement, the Receiver offered for sale almost all of the deposit liabilities of USNB and most of its assets except loans to Westgate-California Corporation, British Columbia Investment Company, and related companies and individuals connected to USNB's President, C. Arnholt Smith (the "Designated Group"); and, to make up the difference between the liabilities transferred and the assets sold, the Receiver offered to supply a

balancing amount of cash, which it borrowed from FDIC.

7. At approximately 4:30 p.m. on October 18, 1973, the Receiver accepted the bid of Crocker National Bank ("Crocker") of \$89.5 million, which was the highest of the bids submitted.

8. The essential provisions of the Purchase and Assumption transaction were as follows:

(a) The assuming bank (Crocker) purchased certain of the assets of USNB from the Receiver and assumed a substantial portion of the deposits and other liabilities of USNB, with the assets and liabilities related to the Designated Group being excluded from the transfer.

(b) Since the amount of the liabilities assumed by Crocker exceeded the value of the assets purchased by it, the difference (less the \$89.5 million paid by Crocker for the value of USNB's banking business as a going concern) was made up by the Receiver in cash. The Receiver obtained the necessary cash, \$130 million, by borrowing from FDIC, the loan being secured by USNB's assets retained by the Receiver. Receiver borrowed an additional \$30 million from FDIC on the security of the retained assets of USNB in order to pay the Federal Reserve Bank in San Francisco the sum of \$30 million to satisfy USNB's obligation to that institution.

(c) Because Crocker required additional capital in order to support its expanded branch structure and almost one billion dollars of new

deposits, FDIC made a \$50 million capital loan to Crocker, evidenced by a capital note payable to FDIC in five years in the amount of \$50 million secured by USNB's assets retained by the Receiver.

(d) Pursuant to written agreements executed on October 18, 1973, between FDIC and the Receiver, the cash advances made by FDIC to the Receiver were secured by liens granted to FDIC on all of the assets in the receivership (i.e., all unpurchased assets).

(e) FDIC entered into an indemnity agreement with Crocker to protect it against unassumed USNB liabilities and certain other types of loss which could result to Crocker from the transaction, but not extending to losses which might arise on the purchased loan portfolio.

9. Upon being advised of the acceptance of the bid and the signing of the required documents, attorneys for the Receiver petitioned the United States District Court for the Southern District of California, in San Diego (Judge Leland Nielsen), for the requisite court approval of the proposed sale of USNB's assets (12 U.S.C. § 192). The Court heard sworn testimony and thereafter granted the required approval at approximately 6:15 p.m. On Friday morning, October 19, 1973, all of the former offices of USNB, except its Nassau, Bahamas office, reopened at their usual business hour as Crocker branches.

10. At the time of its closing, USNB showed on its books an amount in excess of \$100 million on ac-

count of certain letters of credit it had issued. Some of these were commercial letters of credit secured by title documents of goods. Such letters of credit were required, under the Purchase and Assumption Agreement, to be assumed by Crocker. Approximately \$90 million in letters of credit, representing over seventy transactions involving thirty-nine holders, appeared on the bank's records to have been issued in connection with transactions involving as account parties one or another Smith-related enterprise or affiliated person included in the Designated Group. These so-called "standby" letters of credit not secured by title documents of goods were not assumed by Crocker pursuant to the Purchase and Assumption Agreement but were retained by the Receiver in the USNB receivership. However, other such "standby" letters of credit in which the account parties were not members of the Designated Group were assumed by Crocker under the Purchase and Assumption Agreement.

11. On August 14, 1971, plaintiff FEB transferred \$2 million to USNB for the account of Westward Realty Co. (["Westward"]) and received USNB letter of credit No. 70-328 in the face amount of \$2 million. Together with letter of credit No. 70-328, FEB also received note No. 74 of Westward due August 12, 1972, in the face amount of \$2 million in favor of USNB, which note was endorsed in blank by USNB. This credit was renewed on August 24, 1972, and FEB received USNB letter of credit No. 70-515 in the face amount of \$2 million plus interest. Together with letter of credit No. 70-515, FEB also

received note No. 93 of Westward due August 14, 1974, in the face amount of \$2 million in favor of USNB, which note was endorsed in blank by USNB. Neither USNB letter of credit No. 70-515 nor the USNB endorsement of the Westward note was transferred to Crocker for assumption on October 18, 1973, but they were retained in the receivership.

12. On March 7, 1973, plaintiff FEB transferred \$2 million to USNB for the account of Los Altos Management Co. ("Los Altos") and received USNB letter of credit No. 70-612 in the face amount of \$2 million plus interest. Together with the USNB letter of credit, FEB received the promissory note of Los Altos in its favor due March 7, 1974, in the face amount of \$2 million plus 8½% interest per annum. An FEB corporate borrowing resolution form accompanied the letter of credit and note. USNB letter of credit No. 70-612 was not transferred to Crocker for assumption on October 18, 1973, but was retained in the receivership.

13. On March 27, 1974, upon maturity of USNB letter of credit No. 70-612, FEB, through its representatives, presented to the Receiver and to Crocker the documentation required by the said letter of credit and demanded payment thereunder of \$2,000,000 principal and \$181,805.62 interest. The demands for payment were rejected, and appropriate notices of protest and certificates of dishonor were issued. On August 14, 1974, upon maturity of USNB letter of credit No. 70-515, FEB, through its representatives, presented to the Receiver and to Crocker the

documentation required by the said letter of credit and demanded payment thereunder of \$2,000,000 principal and \$209,000 interest. The demands for payment were rejected, and appropriate notices of protest and certificates of dishonor were issued. In addition, FEB has demanded payment from the Receiver pursuant to the USNB endorsement in blank of the Westward note. The Receiver has declined to honor the USNB endorsement and pay the Westward note.

14. On April 10, 1973, plaintiff Sogen transferred \$3,000,000 to USNB for the account of Roberts Farms, Inc. ("Roberts Farms") and received USNB letter of credit No. 70-620 in the face amount of \$3,000,000. Together with the USNB letter of credit, Sogen received promissory note No. 39 of Roberts Farms in the face amount of \$3,000,000 plus interest at $\frac{3}{4}\%$ over market rate on a six-month rollover payable at Sogen, London. USNB letter of credit No. 70-620 was not transferred to Crocker for assumption on October 18, 1973, but was retained in the receivership.

15. On May 3, 1973, plaintiff Sogen transferred \$1,000,000 to USNB for the account of Westward and received USNB letter of credit No. 70-639 in the face amount of \$1 million. Together with the USNB letter of credit, Sogen received promissory note No. 109 of Westward in the face amount of \$1 million plus $9\frac{1}{8}\%$ interest per annum. USNB letter of credit No. 70-639 was not transferred to Crocker for

assumption on October 18, 1973, but was retained in the receivership.

16. On July 20, 1972, plaintiff Sogen transferred \$3,500,000 to USNB for the account of Tri-County Ranches, Inc. ("Tri-County") and received USNB letter of credit No. 70-493 in face amount of \$3,500,000. Together with USNB letter of credit No. 70-493, Sogen received promissory note No. 81 of Tri-County in the face amount of \$3.5 million plus interest payable at Sogen, London. This loan was renewed on July 20, 1973, and plaintiff Sogen received USNB letter of credit No. 70-677. Together with USNB letter of credit No. 70-677, Sogen received promissory note No. 100 of Tri-County in the face amount of \$3.5 million plus 10-11/16% interest per annum payable at Sogen, London. USNB letter of credit No. 70-677 was not transferred to Crocker for assumption on October 18, 1973, but was retained in the receivership.

17. On May 8, 1974, following maturity of USNB letter of credit No. 70-639, Sogen presented to the Receiver and to Crocker the documentation required by the said letter of credit and demanded payment thereunder of principal in the amount of \$1 million and interest in the amount of \$92,517.36. The demands for payment were rejected. On July 25, 1974, following maturity of USNB letter of credit No. 70-677, Sogen presented to the Receiver and to Crocker the documentation required by the said letter of credit and demanded payment thereunder of principal in the amount of \$3.5 million and interest

in the amount of \$381,335.93. The demands for payment were rejected. On April 30 and May 3, 1976, following the maturity of USNB letter of credit No. 70-620, Sogen presented to the Receiver and to Crocker the documentation required by the said letter of credit and demanded payment thereunder of the unpaid principal plus interest. The demands for payment were rejected.

18. Prior to its insolvency USNB maintained an account at FEB and had deposited the sum of \$200,000 with FEB. Subsequent to the insolvency of USNB, FEB offset the funds then in the USNB account, namely, \$200,733.76, against its claims on the USNB letters of credit and endorsement obligation. Although FDIC and the Receiver have demanded that FEB pay said funds to them, FEB has refused to do so.

19. Prior to its insolvency, USNB had deposited the sum of \$2 million with Sogen. Subsequent to the insolvency of USNB, Sogen offset said funds against its claims on the USNB letters of credit. Although FDIC and the Receiver have demanded that Sogen pay said \$2 million to them, Sogen has refused to do so.

20. On May 3, 1973, plaintiff Sogen transferred \$1 million to USNB for the account of Pacific Enterprises, Inc. ("Pacific Enterprises") and received USNB letter of credit No. 70-640 in the face amount of \$1 million. Together with the USNB letter of credit, Sogen received promissory note No. 107 of Pacific Enterprises in the face amount of \$1 million. Said letter of credit was payable between May 3 and

May 24, 1974. However, on or about October 10, 1973, USNB paid Sogen \$1,036,111.10, representing principal and interest on the letter of credit. Thereafter, Sogen returned to USNB letter of credit No. 70-640 and Pacific Enterprises note No. 107, together with a letter of discharge from all liabilities.

21. During the late spring or early summer of 1973, Sogen had acquired information that USNB's President, C. Arnholt Smith, had resigned.

22. Commencing in July 1973, Sogen had requested that USNB provide it with detailed audited financial statements of the account parties under various USNB letters of credit held by it, including the Pacific Enterprises letter of credit.

23. None of the prerequisites for payment of the Pacific Enterprises letter of credit set forth in paragraphs 1 through 3 thereof had been met when USNB prepaid the letter of credit.

24. Subsequent to the October 18, 1973 insolvency of USNB, plaintiffs received from the Receiver proof of claim forms which they were asked to complete and file with the Receiver so that it could be determined whether they should be accorded the status of claimants in the receivership. Proofs of claim were submitted in December, 1973, and January, 1974, by both plaintiffs on all five USNB letters of credit held by them and by plaintiff FEB on the USNB endorsement obligation.

25. During January to July, 1974, FDIC reviewed the various proofs of claim submitted by the holders of the \$91 million in USNB letters of credit which

had not been assumed by Crocker. FDIC had determined that those letters of credit which could be classified as reflecting direct, inter-bank loans to or deposits with USNB were within the class of USNB liabilities which, under the Purchase and Assumption Agreement, should have been assumed by Crocker on October 18, 1973. On the other hand, it concluded that those letters of credit which could be classified as reflecting loans to the account parties guaranteed by USNB standby letters of credit should not be assumed by Crocker.

26. By letters dated June 19, 1974, FDIC, through its Executive Secretary, informed the plaintiffs that all of their letters of credit had been classified as standby letters of credit rather than instruments reflective of direct, interbank transactions. By a letter dated January 16, 1975, FDIC, through its Executive Secretary, informed plaintiff FEB that FDIC had determined that the liability of USNB on its endorsement of Westward note No. 93 should not be transferred to Crocker pursuant to the terms and conditions of the Purchase and Assumption Agreement.

27. Roberts Farms has thus far paid Sogen the sum of \$639,982.69 on its \$3 million note.

28. Plaintiffs failed to file administrative claims under the Federal Tort Claims Act prior to the commencement of this action.

29. a) The transaction by which FEB transferred \$2 million on August 14, 1972, and received from USNB its letter of credit No. 70-515

in the face amount of \$2 million and other documents was a loan to Westward by FEB secured by USNB. Letter of credit No. 70-515 was issued by USNB to FEB to evidence a guarantee by USNB of the loan made by FEB to Westward, and was not required to be assumed by Crocker under the Purchase and Assumption Agreement.

(b) The endorsement in blank by USNB of Westward note No. 93, given to FEB in conjunction with USNB letter of credit No. 70-515, was not a direct interbank liability of USNB to FEB required to be assumed by Crocker under the Purchase and Assumption Agreement.

(c) The transaction by which FEB transferred \$2 million on March 7, 1973, and received from USNB its letter of credit No. 70-612 in the face amount of \$2 million and other documents was a loan to Los Altos by FEB secured by USNB. Letter of credit No. 70-612 was issued by USNB to FEB to evidence a guarantee by USNB of the loan made by FEB to Los Altos, and was not required to be assumed by Crocker under the Purchase and Assumption Agreement.

(d) The transaction by which Sogen transferred \$1 million on May 3, 1973, and received from USNB its letter of credit No. 70-639 in the face amount of \$1 million and other documents was a loan to Westward by Sogen secured by USNB and not an inter-bank deposit or loan. Letter of credit No. 70-639 was issued by USNB

to Sogen to evidence a guarantee by USNB of the loan made by Sogen to Westward, and was not required to be assumed by Crocker under the Purchase and Assumption Agreement.

(e) The transaction by which Sogen transferred \$3,500,000 on July 20, 1973, and received from USNB its letter of credit No. 70-677 in the face amount of \$3,500,000 and other documents was a loan to Tri-County by Sogen secured by USNB and not an inter-bank deposit or loan. Letter of credit No. 70-677 was issued by USNB to Sogen to evidence a guarantee by USNB of the loan made by Sogen to Tri-County, and was not required to be assumed by Crocker under the Purchase and Assumption Agreement.

(f) The transaction by which plaintiff Sogen transferred \$3 million on April 10, 1973, and received from USNB its letter of credit No. 70-620 in the face amount of \$3 million and other documents was a loan to Roberts Farms by Sogen secured by USNB and not an inter-bank deposit or loan. Letter of credit No. 70-620 was issued by USNB to Sogen to evidence a guarantee by USNB of the loan made by Sogen to Roberts Farms, and was not required to be assumed by Crocker under the Purchase and Assumption Agreement.

30. Plaintiffs offered no evidence of the value of their letters of credit on October 18, 1973.

31. In structuring the Purchase and Assumption Agreement, FDIC's decision to exclude plaintiffs' let-

ters of credit from the liabilities transferred to Crocker was reasonable, not arbitrary or capricious, and founded on a rational basis.

32. The purchase and assumption transaction among FDIC, the Receiver and Crocker was not a dividend.

33. The laws of the United Kingdom and of the State of New York as to the power of a bank to set off a deposit held by it where its depositor/obligor becomes insolvent are the same as the law of the State of California and allow such setoff.

34. FEB and Sogen have produced no evidence of what they would have received had their claims been recognized by the receivership of USNB and the assets and liabilities of USNB had been liquidated rather than there having been a purchase and assumption transaction.

35. The October 10, 1973 payment made through USNB to plaintiff Sogen in connection with USNB letter of credit No. 70-640 did not constitute a preferential transfer of funds by USNB to Sogen.

CONCLUSIONS OF LAW

1. The claim of plaintiff FEB under USNB letter of credit No. 70-515 is provable against the Receiver in the face amount.

2. The claim of plaintiff FEB under USNB's endorsement of Westward note No. 93 is provable against the Receiver in the face amount.

3. The claim of plaintiff FEB under USNB letter of credit No. 70-612 is provable against the Receiver in the face amount.

4. The claim of plaintiff Sogen under USNB letter of credit No. 70-639 is provable against the Receiver in the face amount.

5. The claim of plaintiff Sogen under USNB letter of credit No. 70-677 is provable against the Receiver in the face amount.

6. The claim of plaintiff Sogen under USNB letter of credit No. 70-620 is provable against the Receiver in the face amount, less payments received.

7. The claim of plaintiff FEB under USNB letter of credit No. 70-515 was properly classified by FDIC and the Receiver and was not required to be assumed under the Purchase and Assumption Agreement.

8. The claim of plaintiff FEB under USNB's endorsement of Westward note No. 93 was properly classified by FDIC and the Receiver and was not required to be assumed under the Purchase and Assumption Agreement.

9. The claim of plaintiff FEB under USNB letter of credit No. 70-612 was properly classified by FDIC and the Receiver and was not required to be assumed under the Purchase and Assumption Agreement.

10. The claim of plaintiff Sogen under USNB letter of credit No. 70-639 was properly classified by FDIC and the Receiver and was not required to be assumed under the Purchase and Assumption Agreement.

11. The claim of plaintiff Sogen under USNB letter of credit No. 70-677 was properly classified by FDIC and the Receiver and was not required to be assumed under the Purchase and Assumption Agreement.

12. The claim of plaintiff Sogen under USNB letter of credit No. 70-620 was properly classified by FDIC and the Receiver and was not required to be assumed under the Purchase and Assumption Agreement.

13. The purchase and assumption transaction among FDIC, the Receiver and Crocker did not violate 12 U.S.C. § 91.

14. The purchase and assumption transaction among FDIC, the Receiver and Crocker did not violate 12 U.S.C. § 194.

15. Other creditors of USNB did not receive an unlawful preference over FEB and Sogen.

16. The transactions among FDIC, the Receiver and Crocker on October 18, 1973, were authorized by 12 U.S.C. § 1823(e).

17. The lien acquired by FDIC on the assets retained by the Receiver was authorized by 12 U.S.C. § 1823(e).

18. The plaintiffs' causes of action were not required to be brought under the Federal Tort Claims Act, and are therefore not barred in this action.

19. FDIC's actions in negotiating and executing the Purchase and Assumption Agreement among FDIC, the Receiver and Crocker are judicially re-

viewable, and were reasonable, not arbitrary and capricious, and were founded on a rational basis.

20. FDIC's action in investigating and classifying plaintiffs' claims in 1974 are judicially reviewable, and were reasonable, not arbitrary or capricious, and were founded on a rational basis.

21. Plaintiffs' causes of action were not required to be brought under the Administrative Procedure Act, 5 U.S.C. § 701 *et seq.*, and are therefore not barred in this action.

22. Plaintiffs are estopped to deny that their transactions described in Findings of Fact Nos. 11, 12, 14, 15 and 16 were loans to the respective account parties which were guaranteed by USNB, and were not loans or deposits with USNB, as those transactions are indicated on their books and records and the books and records of USNB before the insolvency of USNB on October 18, 1973.

23. Plaintiffs were entitled to setoff against their claims the deposits of USNB held by them.

24. The October 10, 1973 payment made by USNB to Sogen in connection with USNB letter of credit No. 70-640 was not a preferential transfer in violation of 12 U.S.C. § 91.

Dated: March 18, 1977.

/s/ Leland C. Nielsen
LELAND C. NIELSEN
United States District Judge

APPENDIX C

1. 12 U.S.C. 91 provides:

§ 91. Transfers by bank and other acts in contemplation of insolvency

All transfers of the notes, bonds, bills of exchange, or other evidences of debt owing to any national banking association, or of deposits to its credit; all assignments of mortgages, sureties on real estate, or of judgments or decrees in its favor; all deposits of money, bullion, or other valuable thing for its use, or for the use of any of its shareholders or creditors; and all payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another, except in payment of its circulating notes, shall be utterly null and void; and no attachment, injunction, or execution, shall be issued against such association or its property before final judgment in any suit, action, or proceeding, in any State, county, or municipal court.

(R.S. § 5242.)

2. 12 U.S.C. 194 provides:

§ 194. Dividends on adjusted claims; distribution of assets

From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such association, the comptroller shall make a ratable dividend of the money so paid over to

him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives, in proportion to the stock by them respectively held.

(R.S. §5236.)

3. 12 U.S.C. 1821 provides:

§ 1821. Permanent Insurance Fund

(a) Composition; amount of deposit insured; insurance of public funds; aggregate amount of public funds

(1) The Temporary Federal Deposit Insurance Fund and the Fund for Mutuals heretofore created pursuant to the provisions of section 12B of the Federal Reserve Act, as amended, are consolidated into a Permanent Insurance Fund for insuring deposits, and the assets therein shall be held by the Corporation for the uses and purposes of the Corporation: *Provided*, That the obligations to and rights of the Corporation, depositors, banks, and other persons arising out of any event or transaction prior to September 21, 1950, shall remain unimpaired. On and after August 23, 1935, the Corporation shall insure the deposits of all insured banks as provided in this chapter: *Provided further*, That the insurance shall apply only to deposits of insured banks which have been made available since March 10,

1933, for withdrawal in the usual course of the banking business: *Provided further*, That if any insured bank shall, without the consent of the Corporation, release or modify restrictions on or deferments of deposits which had not been made available for withdrawal in the usual course of the banking business on or before August 23, 1935, such deposits shall not be insured. Except as provided in paragraph (2), the maximum amount of the insured deposit of any depositor shall be \$40,000.

* * * * *

(b) Liquidation as closing of bank

For the purposes of this chapter an insured bank shall be deemed to have been closed on account of inability to meet the demands of its depositors in any case in which it has been closed for the purpose of liquidation without adequate provision being made for payment of its depositors.

(c) Corporation as receiver

Notwithstanding any other provision of law, whenever the Comptroller of the Currency shall appoint a receiver other than a conservator of any insured national bank or insured District bank, or of any noninsured national bank or District bank hereafter closed, he shall appoint the Corporation receiver for such closed bank.

(d) Powers and duties of Corporation as receiver

Notwithstanding any other provision of law, it shall be the duty of the Corporation as such receiver to cause notice to be given, by advertise-

ment in such newspapers as it may direct, to all persons having claims against such closed bank pursuant to section 193 of this title; to realize upon the assets of such closed bank, having due regard to the condition of credit in the locality; to enforce the individual liability of the stockholders and directors thereof; and to wind up the affairs of such closed bank in conformity with the provisions of law relating to the liquidation of closed national banks, except as herein otherwise provided. The Corporation as such receiver shall pay to itself for its own account such portion of the amounts realized from such liquidation as it shall be entitled to receive on account of its subrogation to the claims of depositors, and it shall pay to depositors and other creditors the net amounts available for distribution to them. The Corporation as such receiver, however, may, in its discretion, pay dividends on proved claims at any time after the expiration of the period of advertisement made pursuant to section 193 of this title, and no liability shall attach to the Corporation itself or as such receiver by reason of any such payment for failure to pay dividends to a claimant whose claim is not proved at the time of any such payment. With respect to any such closed bank, the Corporation as such receiver shall have all the rights, powers, and privileges now possessed by or hereafter granted by law to a receiver of a national bank or District bank and notwithstanding any other provision of law in the exercise of such rights, powers, and privileges the Corporation shall not be subject to the direction or supervision of the Secretary of the Treasury or the Comptroller of the Currency.

(e) Corporation as receiver of State banks

Whenever any insured State bank (except a District bank) shall have been closed by action of its board of directors or by the authority having supervision of such bank, as the case may be, on account of inability to meet the demands of its depositors, the Corporation shall accept appointment as receiver thereof, if such appointment is tendered by the authority having supervision of such bank and is authorized or permitted by State law. With respect to any such insured State bank, the Corporation as such receiver shall possess all the rights, powers and privileges granted by State law to a receiver of a State bank.

(f) Payment of insured deposits

Whenever an insured bank shall have been closed on account of inability to meet the demands of its depositors, payment of the insured deposits in such bank shall be made by the Corporation as soon as possible, subject to the provisions of subsection (g) of this section either (1) by cash or (2) by making available to each depositor a transferred deposit in a new bank in the same community or in another insured bank in an amount equal to the insured deposit of such depositor: *Provided*, That the Corporation, in its discretion, may require proof of claims to be filed before paying the insured deposits, and that in any case where the Corporation is not satisfied as to the validity of a claim for an insured deposit, it may require the final determination of a court of competent jurisdiction before paying such claim.

* * * * *

4. 12 U.S.C. 1823 provides:

§ 1823. Corporation monies

(c) Loans to closed banks

In order to reopen a closed insured bank or, when the Corporation has determined that an insured bank is in danger of closing, in order to prevent such closing, the Corporation, in the discretion of its Board of Directors, is authorized to make loans to, or purchase the assets of, or make deposits in, such insured bank, upon such terms and conditions as the Board of Directors may prescribe, when in the opinion of the Board of Directors the continued operation of such bank is essential to provide adequate banking service in the community. Such loans and deposits may be in subordination to the rights of depositors and other creditors.

(d) Sale of assets to Corporation

Receivers or liquidators of insured banks closed on account of inability to meet the demands of their depositors shall be entitled to offer the assets of such banks for sale to the Corporation or as security for loans from the Corporation, upon receiving permission from the appropriate State authority in accordance with express provisions of State law in the case of insured State banks. The proceeds of every such sale or loan shall be utilized for the same purposes and in the same manner as other funds realized from the liquidation of the assets of such banks. In any case where prior to September 21, 1950, the Comptroller of the Currency

has appointed a receiver of a closed national bank other than the Corporation, he may, in his discretion, pay dividends on proved claims at any time after the expiration of the period of advertisement made pursuant to section 193 of this title, and no liability shall attach to the Comptroller of the Currency or to the receiver of any such national bank by reason of any such payment for failure to pay dividends to a claimant whose claim is not proved at the time of any such payment. The Corporation, in its discretion, may make loans on the security of or may purchase and liquidate or sell any part of the assets of an insured bank which is now or may hereafter be closed on account of inability to meet the demands of its depositors, but in any case in which the Corporation is acting as receiver of a closed insured bank, no such loan or purchase shall be made without the approval of a court of competent jurisdiction.

(e) Loans on assets as security

Whenever in the judgment of the Board of Directors such action will reduce the risk or avert a threatened loss to the Corporation and will facilitate a merger or consolidation of an insured bank with another insured bank, or will facilitate the sale of the assets of an open or closed insured bank to and assumption of its liabilities by another insured bank, the Corporation may, upon such terms and conditions as it may determine, make loans secured in whole or in part by assets of an open or closed insured bank, which loans may be in subordination to the rights of depositors and other creditors, or

the Corporation may purchase any such assets or may guarantee any other insured bank against loss by reason of its assuming the liabilities and purchasing the assets of an open or closed insured bank. Any insured national bank or District bank, or the Corporation as receiver thereof, is authorized to contract for such sales or loans and to pledge any assets of the bank to secure such loans.

No agreement which tends to diminish or defeat the right, title or interest of the Corporation in any asset acquired by it under this section, either as security for a loan or by purchase, shall be valid against the Corporation unless such agreement (1) shall be in writing, (2) shall have been executed by the bank and the person or persons claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the bank, (3) shall have been approved by the board of directors of the bank or its loan committee, which approval shall be reflected in the minutes of said board or committee, and (4) shall have been, continuously, from the time of its execution, an official record of the bank.

* * * *

IN THE
Supreme Court of the United States

October Term, 1978

No. 78-289

FEDERAL DEPOSIT INSURANCE CORPORATION,
Petitioner,

vs.

FIRST EMPIRE BANK-NEW YORK, *et al.*

BRIEF IN OPPOSITION.

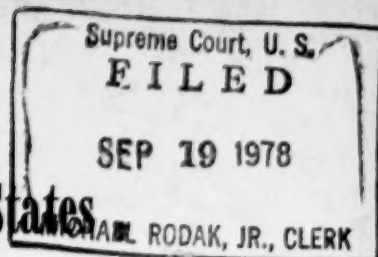
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IN THE
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No. 78-289

FEDERAL DEPOSIT INSURANCE CORPORATION,
Petitioner,

vs.

FIRST EMPIRE BANK-NEW YORK, *et al.*

BRIEF IN OPPOSITION.

Respondents, First Empire Bank-New York and Societe Generale, in response to the petition for certiorari filed herein, urge the Court to deny the same.

Question Presented.

Did the Court of Appeals err in holding that the Federal Deposit Insurance Corporation as Receiver of United States National Bank violated the ratable treatment provisions of the National Bank Act (12 U.S.C. §§91 and 194) when it distributed the assets of the estate of United States National Bank ("USNB") to most general, unsecured creditors of the bank in amounts equal to 100% of their claims but failed to provide for the payment of the claims of the holders of USNB's standby letters of credit?

Statutes Involved.

The following statutes are involved in this case: 12 U.S.C. §§91, 192 and 194 (all sections of the National Bank Act) and 12 U.S.C. §§1821 and 1823 (provisions of the Federal Deposit Insurance Act). The relevant portions of these statutes are set out in Appendix C to the petition, except for §192 which is reproduced *infra* in Appendix A to this brief.

Statement of the Case.

1. Until October 18, 1973, USNB was a national banking association with its principal place of business in San Diego, California. On that date the Comptroller of the Currency declared USNB to be insolvent and appointed the Federal Deposit Insurance Corporation receiver ("Receiver"). See 12 U.S.C. §1821(c). By the terms of a predrafted purchase and assumption agreement, the Receiver offered for sale almost all of the deposit liabilities of USNB and most of its assets, except loans to companies and individuals connected with C. Arnholt Smith (the "Designated Group"); and, to make up the difference between the liabilities transferred and the assets sold, the Receiver offered to supply a balancing amount of cash, which it would borrow from the Federal Deposit Insurance Corporation ("FDIC") by pledging the assets of USNB retained in the receivership estate. (Pet 9a.)¹

Upon being advised of the acceptance by the Receiver of the bid of Crocker National Bank ("Crocker")

¹We note that in the courts below the FDIC and the FDIC as Receiver of USNB appeared as defendants-appellees and cross-appellants. The former appears alone as petitioner in this Court.

and the signing of the required documents, attorneys for the Receiver petitioned the United States District Court for the Southern District of California for court approval of the proposed sale and pledge of USNB's assets. See 12 U.S.C. §192. The court granted the required approval. *In re the Liquidation of United States National Bank*, No. 73-445-N.

At the time of its closing, USNB showed on its books an amount in excess of \$100 million on account of letters of credit it had issued. Some of these were commercial letters of credit secured by title documents of goods. Such letters of credit were required, under the purchase and assumption agreement, to be assumed by Crocker. Approximately \$91 million in letters of credit appeared on the bank's records to have been issued in connection with transactions involving as account parties one or another Smith-related enterprise or affiliated person included in the Designated Group. These standby letters of credit were not assumed by Crocker but were retained by the Receiver. (Pet. 9a, 35a-36a.) However, other standby letters of credit, in which the account parties were not members of the Designated Group, were assumed by Crocker under the purchase and assumption agreement. (Pet. 19a, 36a.)

As a result of the purchase and assumption transaction, except for the holders of the \$91 million in unassumed standby letters of credit, all creditors of USNB as of October 18, 1973, who were not a part of the Designated Group, had their USNB obligations satisfied in full via Crocker's assumption of such obliga-

tions at full value (100 cents on the dollar plus agreed upon interest).²

Respondents, adjudicated "creditors of USNB" (Pet. 2a), hold five USNB letters of credit in face amount of \$11.5 million. Those letters of credit were not transferred to Crocker for assumption on October 18, 1973, but were retained in the USNB receivership. They have never been paid. In the petition the FDIC admits that respondents' USNB letters of credit were rendered "worthless" by its conduct. (Pet. 5.) Yet all other general, unsecured creditors of USNB have already received a 100% dividend plus interest.

²Petitioner never alleged that respondents were in any sense involved in Mr. Smith's fraudulent conduct, thereby warranting special treatment similar to that accorded members of the Designated Group. See 12 U.S.C. §1813(m); 12 C.F.R. §305.1. Now, however, without any reference to the pleadings or evidence of record to support the charges, petitioner seems to imply that respondents were in league with Mr. Smith and his cohorts and made "personal" loans to them which facilitated their unlawful conduct. (See Pet. 3, 5, 9, 10, 11.) The charges are outrageous and, more importantly, totally false. In this respect, and in many others, the petition is simply at odds with the undisputed facts of record.

Respondents (and the other banks similarly situated) are respected domestic and international bankers who engaged in normal banking transactions with USNB and its customers at a time in the early part of this decade when USNB was one of the largest American banks. The loans at issue were all to operating, corporate entities, to wit, Westward Realty Co., Los Altos Management Co., Roberts Farms, Inc. and Tri-County Ranches, Inc. (Pet. 36a-39a), all of which are still extant. The loaning of funds to the corporate customer of a major American bank in return for the customer's note and the bank's standby letter of credit was then, and is now, normal banking practice. See generally Hearings on S. 2347 (Regulation of Standby Letters of Credit), Senate Committee on Banking, Housing and Urban Affairs, 94th Cong., 2d Sess. (1976), especially, 5-11, 238-50. See also FDIC Regulations, 12 C.F.R., §§337.2, 337.10 and 337.11; Comptroller of the Currency Interpretative Rulings and Regulations, 12 C.F.R. §§7.1160, 7.1550, 7.7361, 11.7, 18.2 and 18.3; Federal Reserve System Regulations, 12 C.F.R., §§206.7(c)(9)(viii) and 208.8(c) and (d).

2. Petitioner thus devised and implemented a non-ratable distribution plan in which similarly situated creditors of USNB were treated differently—most received a 100% dividend, the rest got nothing. Petitioner does not deny that in the USNB transaction it discriminated among similarly situated creditors of USNB and that the Receiver distributed the bank's assets in a non-ratable manner; it admits it. The *exclusive* justification for the Receiver's conduct is the contention that 12 U.S.C. §1823(e) authorizes non-ratable treatment of similarly situated creditors of an insolvent national bank in connection with a purchase and assumption transaction. (Pet. 12-20.) In rejecting petitioner's contention, the Ninth Circuit Court of Appeals unanimously held that §1823(e), by its own terms, is *not* a "broad" grant of Congressional authority to the FDIC to "arrange purchase and assumption transactions 'upon such terms and conditions as it may determine.'" (Pet. 12, 16.) Rather, it held that the statute does no more than authorize "the FDIC in its corporate capacity," not as receiver, to arrange for *loans or sales* upon such "terms and conditions . . . that would, in the judgment of the board of directors [of FDIC], qualify the agreement as action that would 'reduce the risk of loss or avert a threatened loss to the Corporation.'" (Pet. 22a-23a.) It correctly concluded that nothing in the statutory language or its legislative history "excused [the Receiver] from behaving like a receiver . . .". (Pet. 23a.)

Such behavior, the court below held, meant compliance with 12 U.S.C. §§91 and 194 (provisions of the National Bank Act). (Pet. 23a.) Noting that those statutes embody a Congressional "policy of equitable

and ratable payment of creditors" (Pet. 24a), the court observed that:

To accede to the FDIC's contentions would seriously undermine the policy firmly set forth in §91 that some creditors are not to be preferred over others, and of §194 that when distributions are made they shall be ratably made. Under its interpretation of the statutes, the FDIC could (subject only to its concession that it must act "reasonably," but without any apparent applicable standard), pick and choose which creditors should be preferred, or permit the acquiring bank to pick and choose. [Pet. 24a.]

In response to petitioner's argument that §194 is only applicable to the distribution of the receivership assets remaining after a purchase and assumption transaction has been effected (*see* Pet. 14), the court below wrote:

We cannot agree. It is the proceeds of a purchase of receivership assets that must be ratably distributed under §194. Here receivership assets (including the cash borrowed from the Corporation) were sold in exchange for Crocker's assumption of debts. That assumption, then, as proceeds of the sale, constitutes a distribution of assets which must give ratable recognition to the rights of creditors of the receivership. *Ex parte Moore*, 6 F. 2d 905, 909 (E.D.S.C. 1925); *see Gockstetter v. Williams*, 9 F. 2d 354 (9th Cir. 1925). [Pet. 21a n.3.]

REASONS FOR DENYING THE WRIT.

1. The decision below is in keeping with the long-established, universally accepted principle that similarly situated creditors of bankrupt or insolvent debtors should be treated equally. This Court has repeatedly emphasized that "one of the objects of the national banking system is to secure, in the event of insolvency, a just and equal distribution of the assets of national banks among unsecured creditors. . . ." *Mechanics Universal Joint Co. v. Culhane*, 299 U.S. 51, 55 (1936). *See also First National Bank v. Colby*, 21 Wall. (88 U.S.) 609 (1875).³ The Court's dedication to this principle of "just and equal distribution" is so strong that it has consistently struck down federal and state statutes that purported to create preferences for particular classes of creditors of insolvent national banks. *See Cook County National Bank v. United States*, 107 U.S. 445 (1883); *Davis v. Elmira Savings*

³Indeed, statements recognizing the requirement of equal distribution among creditors abound in the reported cases. *See Texas & Pacific Ry. Co. v. Pottorff*, 291 U.S. 245, 255 (1934) (the National Bank Act is designed "to insure, in case of disaster, uniformity in the treatment of depositors and a ratable distribution of assets."); *Blakey v. Brinson*, 286 U.S. 254, 263 (1932) (a general creditor "is entitled only to share in the funds of the bank on an equal footing with other creditors who similarly are the victims of its insolvency."); *Atlantic Gypsum Co. v. Federal National Bank*, 76 F. 2d 59, 61 (1st Cir. 1935) (section 194 "is distinctly unfriendly to the recognition of . . . preferred claims."); *Uhl v. First Nat. Bank & Trust Co.*, 24 F. Supp. 275, 276 (W.D. Mich. 1935), *aff'd.*, 94 F. 2d 1013 (6th Cir.), *cert. denied*, 304 U.S. 584 (1938) ("The obvious purpose of . . . [12 U.S.C. §91] and of section 194 of the same title is to secure equality of distribution of the assets of an insolvent bank among its creditors."); *Irons v. Manufacturers' Nat. Bank* 17 Fed. 308, 311 (C.C.N.D. Ill. 1883) (the "manifest intention of the national banking act is a distribution of its assets, in case a bank becomes insolvent, equally among all the unsecured creditors.").

Bank, 161 U.S. 275 (1896). See also *Jennings v. U.S. Fidelity & Guaranty Co.*, 294 U.S. 216 (1935); *Loughman v. Town of Pelham*, 126 F. 2d 714 (2d Cir. 1942); *People ex rel. Barrett v. Union Bank & Trust Co.*, 362 Ill. 164, 199 N.E. 272 (1935).

In a recent decision dealing with the National Bank Act ("NBA"), *Third National Bank v. Impac Ltd., Inc.*, 432 U.S. 312 (1977), the Court noted that:

. . . Congress has [via the provisions of the NBA] consistently and effectively sought to minimize the risk of insolvency for national banks, and to protect bank creditors from disparate treatment. [*Id.* at 323.]

With respect to the role played in this protection by 12 U.S.C. §91, the Court agreed with the Supreme Court of Tennessee, 541 S.W.2d 139, 141 (1976):

. . . the federal state [§91] was intended "to secure the assets of a bank, whether solvent or insolvent, for ratable distribution among its general creditors" [*Id.* at 314-15.]

The principle of equal treatment was recognized and enforced by the FDIC prior to the USNB insolvency. See 12 C.F.R. §306.2. See also FDIC Annual Reports for 1950 at 12, 1953 at 8, 1967 at 20 and 1970 at 3. Prior to USNB, the agency never even suggested that 12 U.S.C. §1823(e) authorized it to accord different distributive shares to the creditors of an insolvent national bank. See FDIC Annual Reports for the period 1935-1973. In fact, the FDIC's current reliance on that statute did not occur until after the pleading stage of this litigation; in their answer to the second amended complaint defendants alleged that they acted "under

the authority and within the discretion vested in them by Title 12 U.S.C. §1823(d) and (e)." (R 370.)⁴

This case would only have warranted the Court's plenary consideration if the Court of Appeals had sanctioned the FDIC's departure from the rule of equal treatment. The holding below that the Receiver of USNB was bound to comply with that rule can hardly be said to represent "an important question of federal law which has not been, but should be, settled by this court." Sup. Ct. Rule 19(1)(b). The only forum that can grant the FDIC as Receiver the dispensation it seeks is the Congress which enacted the ratable distribution rule in 1864 and has adhered to it ever since.

2. Petitioner proffers essentially two reasons in support of its application for the writ. First, it refers to the alleged frequency with which the issue here presented arises. (Pet. 9.) Second, it contends that the Ninth Circuit's decision will adversely affect the agency's ability to deal with national bank insolvencies. (Pet. 9-10.) The only explanation offered in support

⁴We agree with that allegation. Because Crocker required additional capital in order to support its expanded branch structure and almost one billion dollars of new deposits, the FDIC in its corporate capacity made a \$50 million capital loan to Crocker, evidenced by a capital note in that amount payable to the FDIC in five years, secured by USNB's assets retained by the Receiver. (Pet. 34a-35a.) That loan was necessarily made under §1823(e). But the loan by the FDIC in its corporate capacity to the Receiver in order to bring the asset and liability package purchased by Crocker into balance was made pursuant to 12 U.S.C. §1823(d). See *infra* at 14 n.8. See also *FDIC v. Godshall*, 558 F. 2d 220, 221 n.4 (4th Cir. 1977). The latter provision admonishes the Receiver that the "proceeds of every such sale or loan shall be utilized . . . in the same manner as other funds realized from the liquidation of the assets of such banks," i.e., distributed ratably in conformity with the provisions of the NBA, specifically 12 U.S.C. §§192 and 194.

of the latter reason is the argument that because the FDIC desires to afford 100% protection to most creditors of an insolvent bank, the holding below that if some creditors receive a 100% distribution all similarly situated creditors must receive the same distributive share will expose the insurance fund to unacceptable risks. (Pet. 17-19.) Neither reason, however, survives analysis.

A. We have already noted that the discrimination issue never arose prior to the USNB insolvency because the FDIC as receiver never sought to make unequal distributions of an insolvent bank's assets. There is only one reported case of a receiver of an insolvent national bank even attempting to act in that fashion, *Ex parte Moore*, 6 F. 2d 905 (E.D.S.C. 1925), but the court held that such conduct was unlawful under 12 U.S.C. §194.⁵

The statistics set out in the petition concerning bank failures (Pet. 9-10) are meaningless. They do not distinguish between state and national bank failures,⁶

⁵*Ex parte Moore* was, of course, decided prior to the passage of the Federal Deposit Insurance Act ("FDIA") and the creation of the FDIC. That fact is, however, irrelevant on the subject of the applicability of the NBA to the FDIC when it is acting as receiver of insolvent national banks. The distribution of the USNB assets acquired by the Receiver was not under the FDIA but, as petitioner itself recognized by seeking the District Court's approval pursuant to 12 U.S.C. §192, under the provisions of the NBA, including §194. See *In re Anjopa Paper & Board Mfg. Co.*, 269 F. Supp. 241, 252-53 (S.D.N.Y. 1967):

[T]he mandatory appointment of FDIC as a receiver of an insured national bank (12 U.S.C. §1821(c)), subjects it to the provisions of the National Bank Act with regard to the liquidation and/or rehabilitation of insolvent banks (12 U.S.C. §191-197).

⁶Here we are dealing only with national banks and federal law. In state bank cases the conduct of the FDIC as receiver

or between cases involving FDIC assistance to weak, operating banks to facilitate purchase and assumption transactions prior to the appointment of a receiver and cases of actual insolvency.⁷ Most striking is the fact that we are *not* told that any other pending case involves the issue of unequal distributive shares paid to creditors by the FDIC acting as receiver of an insolvent national bank.

B. The ratable dividend rule enforced by the Court of Appeals in and of itself has absolutely no impact on the FDIC's insurance fund. The petitioner's concern for its insurance fund arises not from the requirement of federal law that it treat all creditors equally, but

is controlled by the requisites of state law. See 12 U.S.C. §1821(c). Of the sixty-one banks which the petition notes "closed" since 1970, only 11 were national banks. See FDIC Annual Reports for 1970, p. 3 (Table 1); 1971, p. 4 (Table C); 1972, p. 278 (Table 122); 1973, p. 7 (Table 3); 1974, p. 1 (Table 3); 1975, pp. 198-99 (Table 122); 1976, pp. 274-75 (Table 122); and 1977, p. 15. Thus in only 11 cases since 1970 could the requirements of §§91 and 194 of the NBA come into play. Only 7 of these involved purchases and assumptions. *Id.* Thus that is the *maximum* number of instances in which the interrelation between the NBA and §1823 of the FDIA could possibly be involved.

⁷The total number of national banks in which the FDIC has been appointed receiver through 1977 is 45, not the 101 cited in footnote 7 (at p. 9) of the petition. See FDIC Annual Reports for 1972, p. 279 (Table 123); 1973, p. 7 (Table 3); 1974, p. 7 (Table 3); 1975, pp. 198-99 (Table 122); 1976, pp. 274-75 (Table 122); and 1977, p. 15. Of these 45 only 9 have also involved purchases and assumptions. *Id.* Five of the 9 national bank receiverships resolved by purchases and assumptions involved banks of less than 7 million dollars in assets (in contrast to the 8 billion dollar FDIC insurance fund). Thus contrary to the impression created in the petition, there have not been "more than 500", or "Sixty-one banks [since 1970]" or "101 . . . national banks" (Pet. 9) to which the question at issue is conceivably relevant, but rather only 9 (7 since 1970) of which only 4 have been of significant size.

from its own predilection that most creditors of an insolvent bank receive a 100 cent on the dollar return.

All that the Ninth Circuit did was rule out discrimination. It did not circumscribe the discretion of the FDIC to opt for purchase and assumption transactions or seek to control the terms and conditions of any such arrangements. Moreover, it did not mandate 100% distributions. All that it required in future insolvencies resolved by purchase and assumption agreements was equal treatment of similarly situated creditors via whatever method the FDIC chooses. Thus the court's decision exposes the insurance fund to no greater or lesser risk than already exists by virtue of the \$40,000 per deposit insurance limit. The fund's exposure in future insolvencies is, as it has always been, limited by the amount of the insured deposits.

What the FDIC did in the USNB insolvency was attempt to save the insurance fund millions of dollars at the expense of one group of creditors. There were approximately \$1,165 million in assumable USNB liabilities (including \$91 million in standby letters of credit) of which about \$630 million were insured deposits. The saleable assets amounted to \$855 million plus the premium bid plus the proceeds of the FDIC loan. The results of the bidding and loan transaction increased the asset package to approximately \$1,075 million. (Pet. 6a-7a.) After paying insured deposits of about \$630 million, there would have been \$445 million in assets to pay off \$535 million in liabilities. Under §194 everyone should have received a dividend of about 83%. Had that been the result in this case there would have been no litigation. What the FDIC did, however, was use the \$91 million in assets raised

by USNB on its standby letters of credit to pay off all other creditors at a rate of 100%, giving the letter of credit holders nothing. That result is not justified by 12 U.S.C. §1823(e) or required in order for the FDIC to do purchase and assumption transactions. There is simply no reason why the FDIC should be free to discriminate against one class of creditors.

While respondents assumed the normal business risk that if USNB failed they might lose some of their investment (*e.g.* 17%), they never assumed the risk that in an insolvency the FDIC would single them out as the scapegoats and use their funds to pay off other creditors at full value while depriving them of any return. The FDIC does not, under either the NBA or FDIA, have the discretion to chose a sacrificial lamb who becomes, in effect, a co-insurer for the purpose of giving all other creditors a 100% dividend.

3. The Court of Appeals' reading of the applicable statutes is beyond reproach. Petitioner's entire case is premised on the contention that §1823(e) constitutes a "broad" grant of authority to the FDIC as *receiver* of insolvent national banks "to arrange purchase and assumption *transactions* 'upon such terms and conditions as it may determine.'" (Pet. 16; emphasis supplied.) As the appellate court pointed out (Pet. 22a-23a), the language of the statute is quite to the contrary—all it authorizes is "*loans*" (not transactions) by the *Corporation* to facilitate mergers or purchases and assumptions. It is only those loans which may be upon such terms and conditions as the Corporation determines.

4. Study of the legislative and administrative histories of §1823(e) yields not even a hint that it was intended to authorize the FDIC as receiver of insolvent national banks to discriminate in purchases and assumptions. Prior to USNB there were only 4 receiver-activated purchase and assumption transactions (Home National Bank of Ellenville, New York, 1956; First National Bank of Coalville, Utah, 1969; Skyline National Bank, Colorado, 1973; and First National Bank of Eldora, Iowa, 1973), and in each of those cases all creditors were treated equally.⁸ Indeed all of the reported decisions which have upheld provisions of consolidated plans assisted by the FDIC pursuant to its §1823(e) powers involved purchase and assumption agreements between operating banks. None of those

⁸In such cases the agency petitioned the appropriate court for approval "pursuant to 12 U.S.C. §192 and 12 U.S.C. §1823(d) . . .", not §1823(e). See, e.g., Petition for Sale of Assets and Order in *In the Matter of the First National Bank of Coalville*, No. 3979, Dist. Ct. 4th Judicial Dist., Summit Co., Utah (1969). In USNB the FDIC also relied upon §§192 and 1823(d). Such is not surprising in view of the fact that the agency and the Congress both viewed §1823(e) as applying only to the consolidation of failing banks with sound banks prior to a declaration of insolvency and the appointment of a receiver. See, e.g., Hearings on H.R. 5357 (Banking Act of 1935), House Committee on Banking and Currency, 74th Cong. 1st Sess. 16, 146, 690 (1935); Hearings on H.R. 11844 (Extending Power of FDIC), House Committee on Banking and Currency, 74th Cong. 2d Sess. (1936); 80 Cong. Rec. 5574 (1936); 83 Cong. Rec. 7190-93, 8307 (1938). (During the 1938 House debate on the bill to make §1823(e) a permanent part of the FDIA, Representative Williams made a speech which petitioner quotes in part (Pet. 16-17) and wholly distorts. In his remarks Congressman Williams explained that §1823(e) was a pre-insolvency consolidation statute which gave the agency similar powers to those which it already had in the case of insolvent banks in the hands of receivers. We have reproduced the relevant portions of that speech in Appendix B to this brief.) See also FDIC Annual Report for 1944 at 9, 17-18.

decisions involved receivers or sanctioned unequal treatment of similarly situated creditors of insolvent national banks. See *Thomas P. Nichols & Son Co. v. National City Bank*, 313 Mass. 421, 48 N.E. 2d 49, cert. denied 320 U.S. 742 (1943);⁹ *Lamberton v. FDIC*, 141 F. 2d 95 (3d Cir. 1944); *Brown v. New York Life Ins. Co.*, 152 F. 2d 246 (9th Cir. 1945); *FDIC v. Cloonan*, 165 Kan. 68, 193 P. 2d 656 (1948); *FDIC v. Rectenwall*, 97 F. Supp. 273 (N.D. Ind. 1951).

As Justice Frankfurter once noted, "[o]ne must also listen attentively to what it [a statute] does not say." Frankfurter, *Some Reflections on the Reading of Statutes*, 47 Colum. L. Rev. 527, 536 (1947). Examination of §1823(e) in light of Justice Frankfurter's admonition demonstrates the utter futility of petitioner's position. No matter how §1823(e) is read, no matter what role it was intended to play, it is clear "it does not say" that the FDIC may discriminate among similarly situated creditors in structuring purchase and assumption transactions. There is not one word in §1823(e) which repeals, modifies or qualifies the existing provisions of the NBA dealing with the obligations of receivers when distributing the assets of insolvent banks. Cf. *Harmsen v. Smith*, 542 F. 2d 496, 501 (9th Cir. 1976). The FDIA deals with

⁹The *Nichols* case involved "a voluntary liquidation . . . when it [the selling bank] was not insolvent." 48 N.E. 2d at 50. Accordingly, there was no receiver involved nor any reason to consider the ratable treatment rule of §§91 and 194. Contrary to petitioner's assertion (Pet. 12-13 n.10), the *Nichols* court did not hold that §1823(e) overrode creditors' rights under the NBA. The court held only that under the particular circumstances of that case the inadvertently omitted creditor had no claim against the FDIC under the NBA, but was protected by the solvency of the selling bank.

everything except the distribution of the assets of an insolvent national bank. On that subject it admonishes the receiver to comply with existing law unless statutory authority to ignore the NBA is found. 12 U.S.C. §1821(d). There is no authority to ignore §194.

Conclusion.

For the foregoing reasons, we submit that the petition should be denied.

Dated: September 18, 1978.

Respectfully submitted,

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APPENDIX A.

12 U.S.C. §192 (in Relevant Part).

On becoming satisfied, as specified in sections 131 and 132 of this title, that any association has refused to pay its circulating notes as therein mentioned, and is in default, the Comptroller of the Currency may forthwith appoint a receiver, and require of him such bond and security as he deems proper. Such receiver, under the direction of the comptroller, shall take possession of the books, records, and assets of every description of such association, collect all debts, dues, and claims belonging to it, and, upon the order of a court of record of competent jurisdiction, may sell or compound all bad or doubtful debts, and, on a like order, may sell all the real and personal property of such association, on such terms as the court shall direct. Such receiver shall pay over all moneys so made to the Treasurer of the United States, subject to the order of the comptroller, and also make report to the comptroller of all his acts and proceedings. [Second paragraph omitted.]

APPENDIX B.

**Speech of Representative Clyde Williams of Missouri
Delivered on the Floor of the House of Representatives,
May 20, 1938. 83 Cong. Rec. 7191-92.**

* * *

Now we come to this amendment under consideration, which is short and comparatively unimportant but, in my view, beneficial and helpful. This bill simply establishes as a permanent policy that which has been temporary and, in a sense, experimental. It is not only a question of economy in the administration of the law but also a question of avoiding bank failures as far as possible. In the case of an insured bank in a serious or failing condition, this law permits the Federal Deposit Insurance Corporation to make loans to or purchase part of the assets of such bank in order to reduce the risk or avert a threatened loss to the Corporation.

At the close of the bank holiday many banks were anxious to open up as soon as possible and the people in the various communities were clamoring for banking facilities and accommodations. Under those conditions some banks that were not in a perfectly sound condition were permitted to resume operations. Some of them had old, slow, frozen, and depreciated assets. It was not long until they were in difficulty and it was to give them a chance to clean up and survive, if possible, that this legislation was passed as a temporary measure in 1935. It was tried out with some measure of success, and in 1936 the law was extended until July 1, 1938, in order to give more time to test its efficacy. The measure has proved a success and the Board now thinks it should be made permanent legislation. *The paragraph preceding the one which this bill seeks to*

amend gives the Corporation the authority to make loans on the assets or purchase and liquidate any part of the assets of a closed insured bank. This is permanent legislation. The proposal here is to give the same powers to the Corporation with reference to an insured bank that is still running but may be in difficulty and there is a threatened loss to the Corporation by reason of bad assets in the bank. This provision permits the Corporation to lift from such a bank, while it is still a going concern, its bad assets either by a loan or by purchase and to liquidate those assets, while the good assets may be transferred to another insured bank. This will permit the liquidation of the bad assets and save the good assets from going through the wringer. Under this method only the bad assets are taken over by the Corporation and handled and adjusted by its liquidating agent, while the good assets pass to another bank, which is an insured and a sound and a safe institution, and which will carry on and furnish banking facilities for the community. . . . The experience which the Corporation has had under the operations of this provision proves that to be true. During the 2 years and 8 months this temporary provision has been in effect 101 insured banks have suspended and have been or are now being liquidated in full. The estimated loss to the Corporation is 24 percent of the insured deposits. During that same period 53 insured banks have received aid from the Corporation under the purchase and loan provisions now being considered, and the estimated loss to the Corporation in those cases is 21 percent of the insured deposits. The loss has not only been less, but 53 bank mergers have been effected, outright bank failures have been averted, and normal banking functions have

continued without interruption. It is interesting to know that while the total deposits in the 53 banks were substantially greater than those in the 101 banks the percentage of loss in the former was less than in the latter. It would seem that if this procedure can lessen the loss to the Corporation and also avert the disastrous consequences of a bank failure to a community it has demonstrated its usefulness and that the law should be made permanent. [Emphasis supplied.]

Service of the within and receipt of a copy
thereof is hereby admitted this day
of September, A.D. 1978.
